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BANK EVALUATION CRITERIA IN INTERNATIONAL CORPORATE CASH MANAGEMENT

Case-study: ENSO GROUP

Liiketaloustiede: kansainvälisen liike-
toiminnan pro gradu -tutkielma

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Tutkimuksen tavoitteet

Tutkimuksen teoriaosan tavoitteena oli selvittää kansainvälistymisen vaikutuksia yrityksen kassanhallintaan ja erityisesti pankkisuhteisiin sekä maksuliikenteeseen. Tarkoituksena oli kuvata sitä kansainvälistä ympäristöä, jonka puitteissa yritys tekee pankkivalintansa. Empiriaosassa pyrittiin selvittämään, miten yritys voi arvioida pankkeja ja niiden kassanhallintapalveluita, ja mitkä tekijät vaikuttavat .pankkivalintoihin. Empiirisen tutkimuksen pohjana toimi kansainvälisessä case-yrityksessä tehty pankkivertailuprojekti.

Lähdeaineisto

Teoriaosan lähdeaineistona käytettiin alan kotimaista ja ulkomaista kirjallisuutta, lehtiartikkeleita sekä haastatteluja. Empiriaosan tiedot perustuvat case-yrityksestä ja pankkivertailuprojektissa mukana olleista pankeista saatuun informaatioon. Tiedon keruu tapahtui Suomessa ja ulkomailla.

Tietojen käsittely

Teoriaosassa käsiteltiin kassanhallinnan haasteita kansainvälisen konsernin näkökulmasta. Olemassaolevaa tietoutta jäsennettiin ja selkiytettiin esimerkein.

Empiirinen osa perustui case-tutkimukseen, jossa esitettiin toisaalta pankkien vastauksia kassanhallinnan haasteisiin ja toisaalta, millaiset seikat vaikuttavat case-yrityksen pankkivalintoihin kassanhallinnan näkökulmasta.

Tulokset

Voimakkaan kasvun ja kansainvälistymisen johdosta case-yrityksessä oli jo kauan ollut tarve selvittää olemassaolevien pankkisuhteiden järkiperäisyys ja käytettyjen tilipankkien kapasiteetti nykypäivän kassanhallinnan toteuttajina. Tutkimus osoitti, että pankkien kyvyt tehokkaaseen kassanhallintaan vaihtelevat sekä maakohtaisesti että maan sisällä. Tutkimusmuotona käytetyn pankkivertailuprojektin perusteella voidaan todeta, että perusteellinen konsernin sisäinen tilannekartoitus kassanhallinnan osalta on välttämätöntä ennen varsinaista pankkien välistä arviointia. Pankkivertailun suorittamiseen tarjouskilpailu on tehokas väline, mutta maakohtaiset erot, niin yrityksen sisäisessä kuin ulkoisessakin ympäristössä, on huomioitava tarjouspyyntöjä laadittaessa. Case-yrityksen kohdalla ilmeni tarvetta muuttaa olemassaolevaa tilipankkirakennetta. Tutkimuksessa esitettiin myös EMU:n mahdollisia vaikutuksia kansainvälisen yrityksen kassanhallintoon ja pankkivalintoihin.

Avainsanat

bank, cash management, EMU, evaluation

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ABSTRACT

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BANK EVALUATION CRITERIA IN INTERNATIONAL CORPORATE CASH MANAGEMENT
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Research objectives

The purpose of the theoretical part was to enlighten the impact of internationalization on corporate cash management; especially on bank relations and payments. The aim was to describe the international environment in which a company makes its bank selections. The empirical part tried to explain how a company can evaluate banks and their cash management services and what factors affect bank evaluation. A bank evaluation -project implemented in an international case-company served as a base for the empirical part.

Data sources

In the theoretical part both domestic and international literature, articles and journals as well as interviews were used. The results of the empirical part are based on the information from the case-company and from the banks involved in the bank evaluation -project. Information gathering took place in Finland and abroad.

Data analysis

The challenges of cash management, from the perspective of an internationally operating group, were presented in the theoretical part. Existing knowledge was analyzed and clarified through examples. The empirical part was based on a case-study which presented banks' responses on the demands of cash management on one hand, and on the other hand, what factors influence the bank evaluations of the case-company from the cash management point of view.

Findings

Due to a significant growth and internationalization the case-company felt it necessary to review the rationality of existing bank relations and to study the capacity of those banks in providing cash management services. This work proved that banks' capabilities as providers of cash management services vary both countrywise and within countries. The bank evaluation -project, which was used as a research method, gave clear indications that a thorough group internal mapping of cash management situation is necessary before the actual bank evaluations. An open bid is an efficient tool while gathering information for the evaluation but one should not neglect the differences between countries, both in group internal and external environment, when preparing the requests for an offer. After analyzing the results of the bank evaluation -project there seemed to be a clear need in the case-company to make radical changes to the existing bank network. Additionally, this work presented possible effects of EMU on the cash management and on the bank selections of an international group.

Key words

cash management, bank, EMU, evaluation

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1 INTRODUCTION

1.1 Backround

It has been interesting to notice how an "old" subject, cash management, has reached lately such an attention among both corporates and banks. Inevitably, a fierce competition through internationalization and open markets drive companies and banks to find new keys to success. As mentioned, cash management as such is not a new invention: acceleration of receivables, netting, and group accounts have been topics in international financial literature already before deregulation of money markets. What **is** new, is the approach towards the subject. Cash management is no longer understood only as a cost factor but also as a true possibility for companies to improve their performance and on the other hand, as a new competitive tool from bank perspective.

Companies try to identify all loose cash within the organization and to place it as profitably as possible. Internationalization usually means increased sales volumes but the actual profit rates may depend tremendously on the efficiency in cash management. Banks are facing the most intensive competition of their history and a fight for the customers is fierce. As the providers of cash management services banks have recognized companies needs. They have put a strong emphasis on the development of cash management tools, also keeping in mind the possible effects of The Single Currency.

Managing international business without banks is hardly possible. Therefore, an international company should be well aware about the possibilities and constraints related to banks' services and to work in close cooperation with the best banks available. But how to find the best banks? How to evaluate theirs services? What kind of criteria can be used? This study aims firstly to help cash managers of international companies to recognize the need for a thorough investigation of existing bank relations and payment systems and secondly, to provide the managers with the updated information for an evaluation process of international cash management banks.

Previous studies in this field are mainly oriented in searching for cash flow optimization models and in creating theories about efficient cash management. Some case-studies have been done where the theories have been tested in a case-company, but an updated research, where practical company considerations and the latest development in the banking world are examined together in an international environment, is lacking. It seems that there is a need for a real understanding of present (and future) cash management, its international aspects, and the "players" within it.

1.2 Purpose of the study

The main research question of this study is: *What are the key determinants of bank evaluation for corporate cash management in international business?*

The objective is to present the environment in which an international company makes its banking selections and to search for criteria for making the bank evaluations from corporate cash management perspective. Strategies and techniques of cash management are discussed as well as environmental considerations. The practical point of view is that of a large, Finnish, international company.

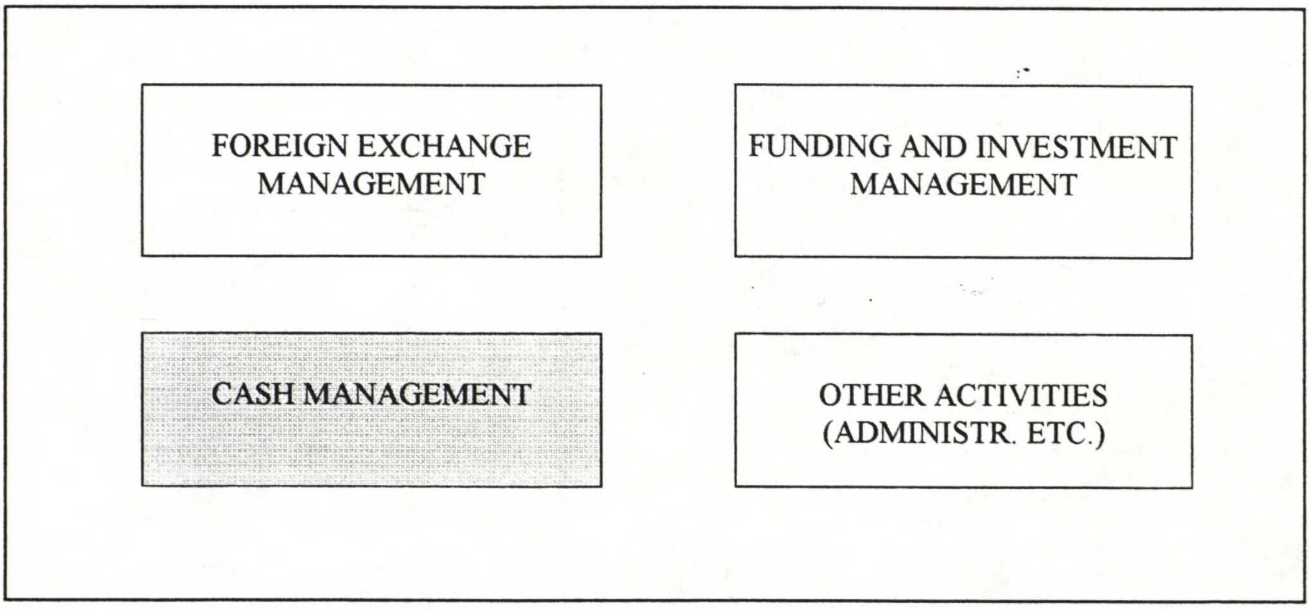
The main research question is divided to following sub-questions:

- How does the internationalization affect company's cash flows and bank relations?
- How do the banks try to meet the cash management needs of an international group?

1.3 Definitions and limitations

In this study *cash* is defined as the very liquid assets of the company, i.e. cash in hand and the bank accounts. Cash management is part of the overall financial function of a company. Figure 1 presents the different financial activities in an internationally operating firm.

Figure 1. Financial function of an international company.



Source: Kasanen & others (1997, 31)

Following examples illustrate the large variety of possibilities in defining *cash management*:

Johnson & Aggarwall (1988, 81) describe cash management as a function with which company maintains an adequate level of liquid assets, optimises its cash flows, and improves organisation's awareness of the costs of financing everyday business. They divide cash management as follows:

a) Management of working capital. The target is to reduce the needed amount of working capital and to minimise delays of incoming payments.

b) Management of cash transfers. The goal is to minimise the total cost caused by cash transfers and to reduce the risk related to transfers.

c) Management of payments. A strong emphasis is put on good bank relations in order to secure an efficient payment traffic.

Bumister (1982, 83) explains that cash management is a process in which the company seeks to maximise its revenues and/or to minimise the costs related to its borrowing by controlling its cash flows and financial position as well as possible and by taking into account company's overall goals. According to Bumister cash management concentrates on four areas:

- management of incoming payments
- management of outgoing payments
- investment of the excess cash
- filling the cash shortages and exploiting inexpensive funding possibilities

Also Leppiniemi (1995, 115) finds several possibilities in defining cash management. Within a narrow perspective it means company's effort to maximise the profit on liquid assets and receivables and to use short term funding, both quantitywise and costwise, as inexpensively as possible. In a wider context, however, cash management touches not only the financial aspects but also many operational functions such as delivery times, inventory levels, etc.

Hallipelto (1986, 33) has studied the municipal cash management and brings in the following division:

a) Treasury prognosis
- liquidity planning
- budgeting

b) Cash flow management
- incoming and outgoing payments
- bank account structure

c) Bank relations
- negotiation principles
- credit facility policies
- benchmarking of different financial institutions

d) Investments of excess cash/settlements of deficits

- investment policies
- short-term financial decisions
- matching of the targets

According to Hallipelto (1986, 33-35) the starting point of an efficient cash management is to prepare prognosis for the treasury. Then, to manage efficiently the cash flows, it is necessary to guarantee reliable and inexpensive transfers and to build a rational account structure. Bank relations are a very decisive factor and it is important to maintain good relations to all financial institutions used by the organisation. Investments of excess cash are made to earn better return on invested capital. Credibility and the costs of borrowing are considered when planning the settlements of deficits.

In his study Kytönen writes: "Corporate cash management is an important part of company's short-term financial management. It takes care of the optimization of company's cash flows, so that all excess cash can be liberated to profitable purposes..." (Kytönen 1990, 6). According to Kytönen the most of the models handling cash management are using a so called inventory-theoretical approach for which the basis can be found in the money theory and in the theories for the demand of money. "There is hardly any research information about the real decision-making concerning the corporate cash management. However, it would be vitally important to know company's real behaviour when trying to develop more sophisticated models to support its daily decision making or to explain its behaviour..." says Kytönen (1990, 7-8).

As already mentioned, the purpose of this study is to enlighten the practical considerations of bank evaluation in international corporate cash management. Within the area of cash management the focus of both banks and the case-company has lately been clearly on the management of cash flows and on the bank relations and this study has been built accordingly. Therefore, treasury prognosis and investment strategies as well as liquidity optimization models and risk management are not discussed in detail. With these choises the study tries also to respect the boundaries between different departments at Helsinki School of Economics and Business Administration.

There are also limitations in the empirical part (evaluations of banks) depending on the various needs of the case-company. For example, certain payment methods such as collections and letters of credit are not included because of their small importance in countries under survey. Also, netting was excluded because of the small usage.

1.4 Structure of the study

The theoretical part (a literature review) of the study has been divided into two chapters. Chapter 2 presents the effects of company's internationalization on cash management. In Chapter 3 an international cash management environment, especially the bank related issues, is discussed. These two chapters create a theoretical framework in which the case-study (an empirical part) has been implemented. The purpose of the theoretical part is not to discuss about the actual bank evaluations. This is simply because the issue is lacking from the literature; at least in the form required for this study. Instead, the first part of this research paper tries to give a reader a closer view on the international environment and on the factors affecting the bank evaluation from the corporate cash management perspective. The variety of possible evaluation criteria and an example of a bank evaluation is then presented in the empirical part as a case-study. A methodology behind the case-study is explained in Chapter 4. Findings and results of this work are discussed in Chapter 5. A summary, with both theoretical and managerial implications, and recommendations for further studies can be found in Chapter 6, which concludes this work.

2 EFFICIENT CASH MANAGEMENT - A NEW COMPETITIVE EDGE IN INTERNATIONAL BUSINESS

2.1 Improving profits with existing sales

Traditionally the product excellence has been the driving force of the Finnish companies. Specialisation on unique innovative products and exploitation of certain niche-areas have enabled some Finnish firms to gain experience in international business. Nevertheless, a fierce international competition and open markets are forcing also the Finnish companies to consider moving on in finding new areas of excellence (Luostarinen 1994, 26). Finance, through the deregulation of financial markets, has created interesting options for companies to improve their performances in international business.

Cash flow management, as a part of the overall cash management, has become an important source of value addition for a multinational company. It is a relatively economical way of improving the company performance since big gains can be achieved with small inputs (Hedman 1992, 22). To illustrate the importance of cash flow management, Table 1 shows how much the company can earn (interest savings) if the cash inflows are received one day earlier.

Staying at the top in international business only with a unique product has proven to be very difficult or even impossible. Therefore, one should always be searching for possibilities to become a leader in other areas such as marketing, research and development, informations or perhaps in finance. When a company looses one of its competitive edges, it should be prepared to give something back. That is called strategic planning (Luostarinen 1994, 30).

Table 1. Value of one day invoicing - how much capital can be released if the receivable is accelerated by one day (a 5 % interest rate and 250 working days per annum are used to simplify the illustration).

Value of one year's invoicing	Value of one day	
FIM	Capital	Interest
50 000 000	200 000	10 000
100 000 000	400 000	20 000
250 000 000	1 000 000	50 000
500 000 000	2 000 000	100 000
750 000 000	3 000 000	150 000
1000 000 000	4 000 000	200 000
2 500 000 000	10 000 000	500 000
5 000 000 000	20 000 000	1 000 000
7 500 000 000	30 000 000	1 500 000
10 000 000 000	40 000 000	2 000 000
20 000 000 000	80 000 000	4 000 000

Source: Hedman (1992, 22)

2.2 Organising cash management in different stages of internationalization

Back (1988, 10-13) has explained the tasks of finance function in different phases of company's life cycle. In the following Back's model is adjusted to present the position of cash management in different stages of internationalization.

Figure 2. Company growth profile

STAGE OF INTERNATIONALIZATION	PRODUCT FAMILY
Stage 1 DOMESTIC (local manufacture)	Single product Multi-product
Stage 2 NATIONAL (exporting abroad)	Single product Multi-product
Stage 3 MULTINATIONAL (subsidiaries manufactoring abroad)	Single product Multi-product

Source: Back (1988, 10-13)

In stage 1, where a company manufactures only one product and sells it to domestic market, cash management will be highly centralised. This will reflect the requirements of the founder or founders to be in control. The financial arrangements will be kept simple (one banker, personal relationship important). A multi-product situation does not alter the position of cash management. However, a change from a single location to a multi-location may bring some decentralisation to the cash management. A local plant accountant could be appointed and a local bank account might be required to facilitate payment of wages and local bills. A new banker may be introduced to the organisation.

In stage 2, where the company is manufacturing one product which it sells at home and abroad, the cash management control is likely to be central, though production may be multi-locational. Back has used a term "national" in this level while from Finnish perspective a word "international" could be perhaps more appropriate. It is quite probable that Back has prepared this model for US companies and keeping in mind the vast size and the structure of the continent this approach is then more understandable. At this stage sales abroad may be direct, but more likely through a local agent familiar with the local customers. Sales may be invoiced to the agent in base or local currency. An efficient funds collection service will be required to ensure good value as soon as possible. This may imply multi-banking. In order to receive funds quickly (unless paid direct on open account terms) the company will need a local bank account for the clearing of cheques and drafts. The bank chosen should be a member of the local clearing system and have good correspondent bank links with the lead banker to the company. Such rationality will ensure that funds will be passed swiftly along the chain to the company's own account in the base currency.

Multi-product situation tends to bring more complexity already at this stage. More control is likely to be delegated from the centre in all areas. The central finance function will monitor funding activity, but the local financial manager will be responsable for raising finance, buying and selling foreign currency, and local banking relationships. This can lead to anomalies in financial control. One subsidiary could be selling currency while another is buying it, and one subsidiary could be borrowing from a bank while another has surplus funds to invest.

In stage 3, where a multinational company has overseas subsidiaries manufacturing company's products, a delegation of cash management into different entities is normal. Regional treasury centres may be set up in tax-favourable locations to ensure the efficient handling of the funds. A central finance team will probably monitor the buying and selling of exchange on behalf of the overseas subsidiaries. If handled locally, the finance function will again create a multi-bank situation, with subsidiaries setting up their own contacts. The operational difficulties at the group level noted before could occur. The system may not be efficient.

A multinational, multi-product group, is the final stage of company growth complexity. Overseas there will be fully integrated operations, sub-holding subsidiaries, cross-border holdings and so forth. At this stage the cash management structure will likely be highly decentralized in order to retain local management motivation - as well as being the most practical solution. The group will be multi-banked, with a complex network of banking and financing arrangements.

In summary, the position of cash management varies depending on the type of organisation. At each stage of company's evolution new financial demands are put on it, and the question of centralization and decentralization have to be considered from many aspects. The affects of centralization and decentralization will be examined closer later in this work.

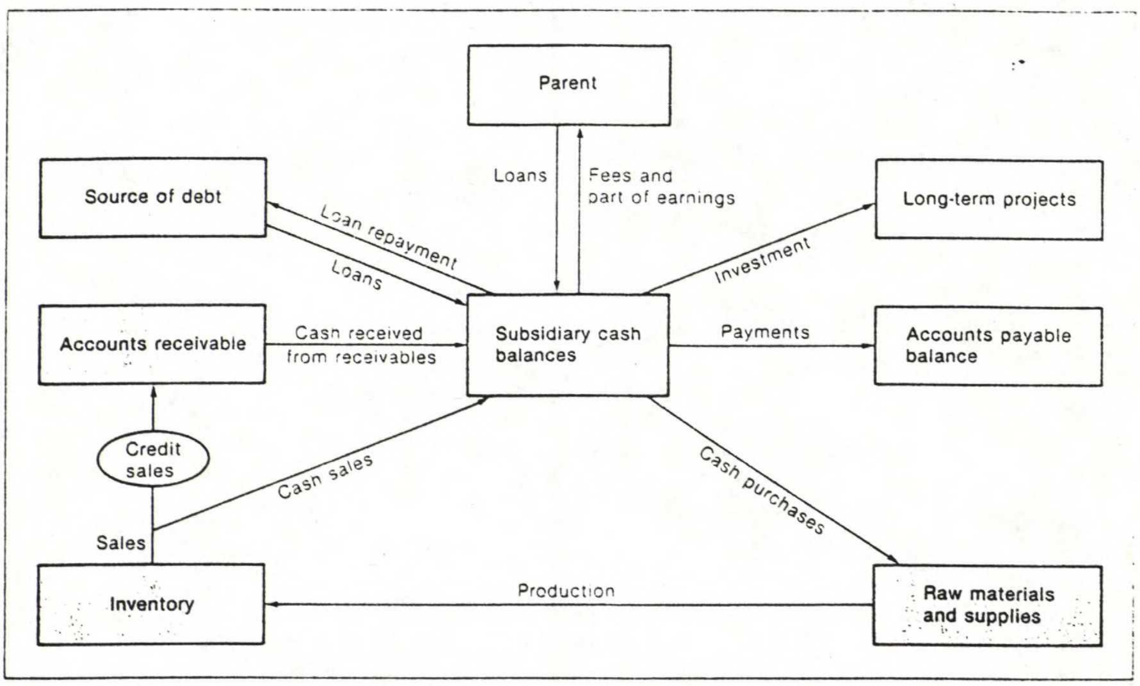
2.3 Strategic aspects of international cash management

2.3.1 Subsidiary perspective

2.3.1.1 Subsidiary's cash flows

The management of working capital (such as inventory, accounts receivable, and cash) has a direct influence on the amount and timing of cash flow. Working capital management and cash management are integrated. This is enlightened in a Figure 3 followed by a detailed explination (Madura 1990, 372-374).

Figure3. Cash flow from a subsidiary's perspective



Source: Madura (1990, 373)

International purchases

The subsidiary will normally have a more difficult time forecasting future outflow payments if its purchases are international rather than domestic because of exchange rate fluctuations. In addition, the possibility exists of substentially higher payments due to appreciation of the invoice currency. Consequently, the firm may wish to maintain a large inventory of supplies and raw materials so that it can cut down on purchases if the invoice currency appreciates and instead draw down from its inventory. Still another possibility is that imported goods from another country could be restricted by the importer's government (through quotas, etc.). In this event, a larger inventory would give a firm more time to search for alternative sources of supplies or raw materials. A subsidiary with domestic supply sources would not experience such a problem and therefore would not need as large an inventory.

Outflow payments for supplies will be influenced by future sales. If the sales volume is substentially influenced by exchange rate fluctuations, its future level becomes more uncertain, which makes outflow payments for supplies more uncertain. Such uncertainty may force the subsidiary to maintain larger cash balances in order to cover any unexpected increase in supply requirements.

Sales

Subsidiaries use their raw materials and/or supplies in their production process. If their finished goods are exported overseas, the sales volume may be more volatile than if the goods were sold only domestically. This could be due to the fluctuating exchange rate of the invoice currency. Demand for these finished goods by importers would most likely decrease if the invoice currency appreciates. The sales volume of exports is also susceptible to business cycles of the importing countries. If the goods were sold domestically, the exchange rate fluctuations would not have a direct impact on sales, although they would still have an indirect impact, since they influence prices paid by local customers for imports from foreign competitors.

Credit standards

Sales can often be increased when relaxing credit standards. However, it is important to focus on cash flows due to the sales rather than sales itself. Looser credit standards may cause a slowdown in cash inflows from the point of sales, which could offset the benefits of increased sales. In any case, it is important to recognize that accounts receivable management is an important part of the subsidiary's working capital management because of its potential impact on cash inflows.

Payments to the parent

The subsidiary may be expected to periodically send dividend payments and other fees to the parent. When these payments are known in advance and denominated in the subsidiary's currency, forecasting cash flows is easier for the subsidiary.

Excess and deficient cash

After accounting for all outflow and inflow payments, the subsidiary will either find itself with excess or deficient cash. Thus, it will periodically need to either invest its excess cash or borrow to cover its cash deficiencies. If it anticipates a cash deficiency, short-term financing is necessary. If it anticipates excess cash, it must determine how the excess cash should be used. Investing in foreign currencies can sometimes be attractive, but exchange rate risk makes the effective yield uncertain.

Credit lines

Liquidity management is a crucial component of a subsidiary's working capital management. Subsidiaries commonly have access to numerous lines of credit and overdraft facilities in various currencies. Therefore, they may maintain adequate liquidity without substantial cash balances. Potential access to funds is more relevant than cash on hand.

2.3.1.2 Subsidiary's bank relations

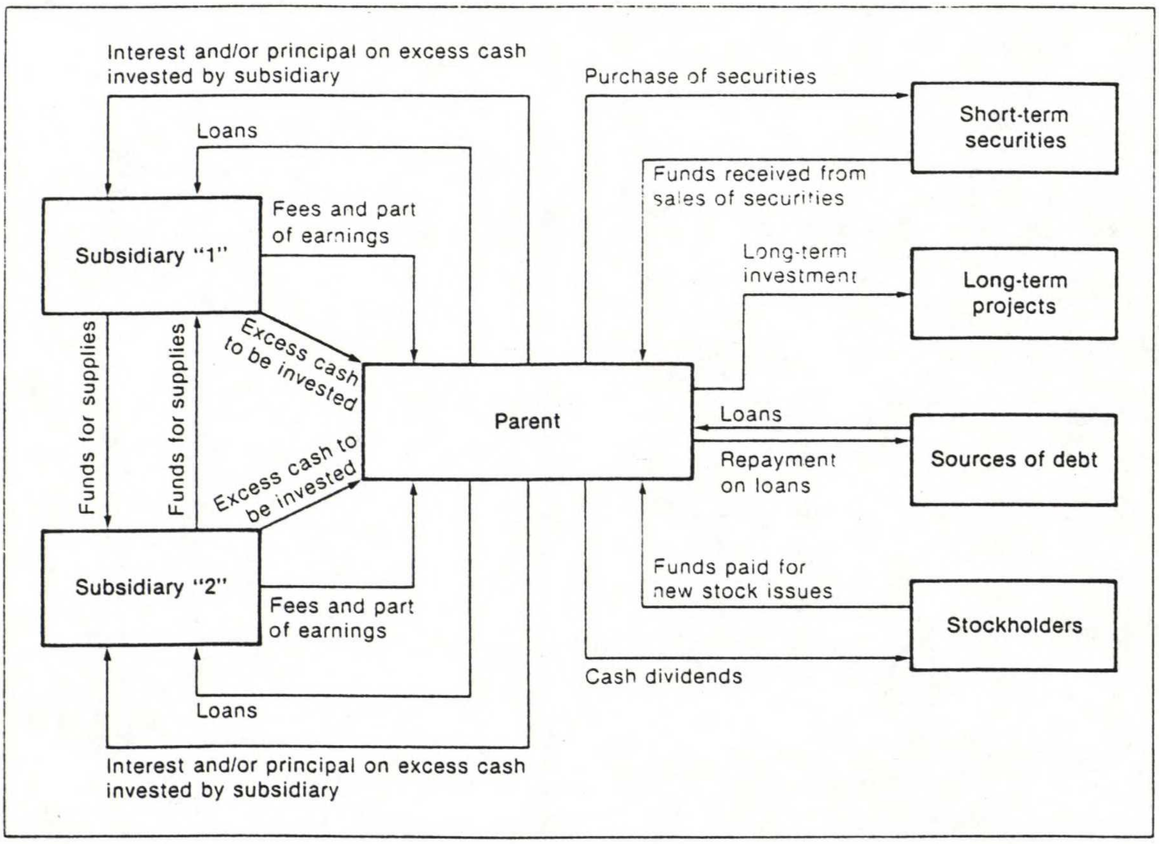
For a group it is important that the banks involved in its affaires consider the group as a "Group Client" (Hedman, 1992, 156). A large international group has substantially bigger negociation power than a single firm, and the terms offered by banks are normally more interesting. A certain bank affair or a contract may seem optimal to a subsidiary but it may lead to under optimization from the group's point of view. Therefore, it is recommended that the subsidiaries do not negociate with banks without permission of the group's Finance Department. There should be a clear understanding about the bank affaires that can be handled by subsidiaries alone (Hedman 1992, 156). Cash pooling and other cash flow optimization techniques offered by banks and involving the subsidiaries are discussed more in detail in Chapter 2.4.

2.3.2 Centralized perspective

Each subsidiary should manage its working capital by simultaneously considering all of the points discussed above. Often, though, each subsidiary is more concerned with its own operations than with the overall operations of the MNC. Thus, a *centralized cash management group* may need to monitor, and possibly manage, the parent-subsidiary and intersubsidiary cash flows. This role is critical since it can often benefit individual subsidiaries in need of funds or overly exposed to exchange rate risk.

Figure 4 illustrates the cash flows of overall MNC. It shows a simplified cash flow diagram for an MNC with two subsidiaries in different countries.

Figure 4. Cash flow of the overall MNC



Source: Madura (1990, 375)

Figure 4 reflects the assumption that the two subsidiaries periodically send fees and dividends to the parent and often send excess cash to the parent (where the centralized cash management process is assumed to take place). These cash flows represent the incoming cash to the parent from the subsidiaries. The subsidiaries also have cash flows between themselves due to purchasing of supplies from each other. Cash flows from the parent to the subsidiaries are mainly loans and interests. (Madura 1990, 374-375)

2.3.2.1 Arguments for and against centralized cash flow management

Often mentioned argument against a centralized cash flow management is that the subsidiaries loose control and power on their receivable and that leads to a non-motivation and problems in parent-subsidiary relationship. Therefore, it is recommended that the cash flow management system should be built so that the above mentioned feeling is avoided, and the planning is made in good cooperation between the parent and the subsidiaries. A subsidiary should always be responsible on its receivable, and all the problems should be handled between the subsidiary and the customer; head office cannot be aware of the local practises and conditions as well as the local agents (Hedman 1992, 121).

Centralisation allows the negosiation of financial resources from a position of greater strength. A large group with big volumes will be taken more seriously in the banking sector than just one local subsidiary with much smaller size of transactions. Additionally, the company is able to monitor currency and interest rate flows, thus optimizing them for the best overall return to the group (Back 1988, 13). The advantages of centralized cash flow management appear also as a number of techniques which can be exploited in order to gain efficiency and profitability in group's cross-border transactions. These techniques are discussed in detail in Chapter 2.4.

2.3.2.2 Globalization vs. centralization

In many companies the optimum situation seems to be a decentralized management control with centralized financial control, combined with a monitoring process to oversee local bank contacts (Back 1988, 13). Also for an internationally operating Finnish group this seems to be the most practical solution, at least today. In the future, however, if the Finnish groups reach a globalization phase, the situation might change, and even more decentralized strategy may be necessary. That can attribute, for example, to increased need of subsidiaries to make financial decisions locally, and operating in several time zones. Head office finance department will serve more and more as an internal bank for the group, and the operative side of cash management is decentralized fully to the subsidiaries (Suuraho 1997).

2.4 Techniques to optimize cash flows

Cash flows can be optimized by a) accelerating incoming cash, b) pooling c) using a central account system d) using netting, and e) minimizing the tax on cash flow. Each of these tasks is discussed in turn.

2.4.1 Accelerating cash inflows

The first goal in international cash management is to accelerate cash inflows, since the quicker the inflows are received, the quicker they can be invested or used for other purposes. Some practical tools are presented next.

Lock box

Lock boxes are post office box numbers to which customers are instructed to send their payments. This method is recommended especially in countries where the use of cheques/drafts is common, for example in USA and England. The processing of incoming cheques at a lock box is normally taken care of by a bank on a daily basis. Instead of sending the cheque to the company the client sends it to the lock box, and the bank credits the company account the same day. Mailing times can be quite long in international transactions and therefore, a use of lock box may be quite valuable for a cash flow management. In addition, in Finland the bank charges of cashing a foreign cheque are very high, so it is cheaper to cash the cheque at a local bank. (Madura 1990, 376, and Katrama 1997, 9)
The same idea is in opening of so called collection accounts, which are bank accounts in local banks to get the cash flows faster to the use of the group and to avoid the time span between the foreign bank and the bank in Finland (Katrama 1997, 9).

Factoring

Factoring can be studied from several perspectives but in this work the main interest is only on its effects on the acceleration of cash flows. Factoring can be defined as follows: exchange of company's accounts receivable into immediate cash (with a discount) by using a special factoring company (Tepora & Takki 1994, 4). The exporting company sells its accounts receivable to a third party, known as a *factor*, which takes care of the collection of payments. For providing this service, the factor usually purchases the receivable at a discount and also receives a flat processing fee. The sale of the receivable to the factor provides immediate payment and improves the exporter's cash flow. The factoring services are normally provided by the factoring subsidiaries of commercial banks, commercial finance companies, and other specialized finance houses (Madura 1990, 336).

Compared to domestic receivable the credit of foreign receivable is substantially longer, normally 90-120 days, so the factoring is an important alternative for the cash flow management of a Finnish group operating internationally (Tepora & Takki 1994, 150). Naturally, the limit where the discount given to the factor exceeds the benefits of the factoring has to be studied carefully. Factoring may be a very expensive method as well.

2.4.2 Pooling

Pooling occurs when cash is held as well as managed in a central location. The advantage of pooling is that cash needs can be met wherever they occur without having to keep precautionary balances in each country. Uncertainties and delays in moving funds to where they are needed require that some balances are maintained everywhere, but with pooling, a given probability of having sufficient cash to meet liquidity needs can be achieved with smaller cash holdings than if holdings are decentralized. The reason pooling works is that cash surpluses and deficiencies in different locations do not move perfectly parallel fashion. As a result, the varience of total cash flows is smaller than the sum of flows for individual countries. If a group is to have sufficient amounts in each individual country, it must maintain a large cash reserve in each. However, if the total cash needs are pooled in, for example Finland, then when the needs in one country is unusually high, it can be met from the central pool because there will not normally be unusually high drains in other countries at the same time (Levi 1990, 1996).

2.4.3 Central account system

A group with its subsidiaries posseses normally a good number of bank accounts, and very easily a situation arrives where there is a credit balance in one account and a debit balance in another. While the interest charged on debit balances is normally higher than is paid on credit balances, the use of a central account is justifiable.

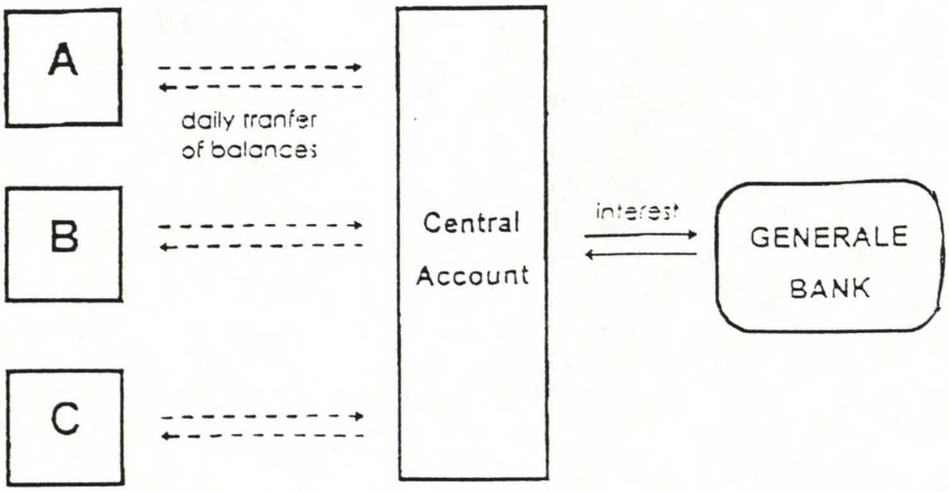
A central account system consists of a top account (or a central account) and a number of sub-accounts (transaction accounts) which are connected to the top account (see Figure 5). Sub-accounts are those of the subsidiaries', and there is a daily transfer of the balances of sub-accounts to the top account. A sub-account which has a debit balance is credited from the top account and all the surpluses of sub-accounts are transfered to the top account. This means that at the end of each day the sub-accounts show a zero-balance and the interest is only calculated on the top account balance. The advantages of this method are:

- the interest costs of the group are reduced, because the need for external loans become smaller due to the use of internal arrangements (top account)
- group internal transfers can be made without loosing value dates
- monitoring of group's cash flows and balances is more simple

(Karlsson 1992, 57-58)

Figure 5 is a simple illustration of a central account system defined above:

Figure 5. Central account system



Source: Generale Bank (1997)

This so-called zero-balancing pooling or physical pooling is not the only alternative for the use of a central account. Also a "notional pooling" is possible but with some country limitations. In notional pooling only the balance calculations of sub-accounts are transfered to the central account, not the actual cash. Notional pooling is a more motivative technique from a subsidiary. point of view since the results of different actions, eg. receivable acceleration, can be monitored at their own accounts; they do not just show zero at the end of the day. (Deutsche Bank 1997)

2.4.4 Netting

Commonly an international group has divisions in different countries, each having accounts receivable and accounts payable, as well as other sources of cash inflows and outflows, denominated in a number of currencies. If the divisions are left to manage their own cash, most certainly some unnecessary transaction costs of currency conversion will appear. This can be illustrated by following example of a group with two subsidiaries located in different countries. Any time one subsidiary purchases goods from a second subsidiary, it may need a foreign currency to make a payment. The second subsidiary may do the same when purchasing goods from the first subsidiary. Both subsidiaries could avoid (or at least reduce) the transaction costs of currency conversion if they netted out the payments. That is, they should account for all of their transactions over a given period to determine one net payment (Madura 1990, 376). This calculation requires some central coordination of cash management.

The key benefits of the netting are as follows. First, it reduces the number of cross-border transactions between subsidiaries, thereby reducing the overall administrative costs of such cash flows. Second, it reduces the need for foreign exchange conversion, and thereby the conversion costs are smaller. Third, the process of netting forces tight control over information on transactions between subsidiaries. Finally, cash flow forecasting is easier since only net cash transfers are made at the end of each period (Madura 1990, 377).

Bilateral and multilateral netting

A bilateral netting system involves transactions between two units, such as between the parent and a subsidiary or between two subsidiaries. A multilateral netting system usually involves a more complex interchange among the parent and several subsidiaries. For most large international groups, a multinational netting system would be necessary to effectively reduce administrative and currency conversion costs. Such a system is normally centralized, so that all necessary information is consolidated. From the consolidated cash flow information, net cash flow positions for each pair of units is determined, and the actual reconciliation at the end of each period can be dictated (Madura 1990, 377).

Leading and lagging

The benefit of reduced transaction costs depends partly on the length of the period over which it is feasible to engage in netting. This in turn depends on the ability to practice *leading* and *lagging* (Levi 1996, 421-422).

Leading and lagging involve the movement of cash inflows and outflows forward and backward in time so as to permit netting and achieve other goals, such as speculation with exchange rates and reductions in taxes. For example, if a Finnish company has to pay £1 million for the raw material on June 10 and has received an order of finished goods for £1 million from Britain., it might attempt to arrange payment for about the same date and thereby avoid exposure. If the payment for the finished goods would normally have been *after* June 10 and the receivable is brought forward, this is called leading of the export. If the payment would have been *before* June 10 and is delayed, this is called lagging of the export. Of course, the opportunities for netting via leading and lagging are limited by the preferencies of the other party. However, when transactions are between divisions of the same multinational, the scope for leading and lagging (for the purpose of netting and achieving other benefits such as deferring taxes) is considerable. Recognizing this, numerous governments regulate the length of credit and acceleration of settlement by putting limits on leading and lagging. The regulations vary greatly from country to country, so the cash management has to keep current with what is allowed and where. (Levi 1996, 422)

2.4.5 Minimizing tax on cash flow

To further optimize cash flows, a multinational group may consider the tax consequences of altering its cash flow. If, for example, the host country government of a particular subsidiary places a high withholding tax on subsidiary earnings remitted to the parent, the parent of the group may instruct the subsidiary to temporarily refrain from remitting earnings and to reinvest them in that host country instead. As an alternative approach, the group may instruct the subsidiary to set up a research and development division that will benefit subsidiaries elsewhere. The main purpose behind this strategy is to search for a way to efficiently use the funds abroad if the funds cannot be sent to the parent without excessive taxation.

Another method of reducing taxes is through the establishment of a reinvoicing center. The main objective is to shift profits to subsidiaries where tax rates are low. Title to goods passes through the reinvoicing center, but the goods not. The invoice is normally denominated in the currency of the exporting subsidiary. The reinvoicing centers serve as a centralized payments facility, and the subsidiaries are charged a fee for using the facility. This arrangement essentially shifts profits from other subsidiries to the reinvoicing center and therefore reduces overall taxes incurred by the group. (Madura 1990, 378-381)

3 INTERNATIONAL CASH MANAGEMENT ENVIRONMENT

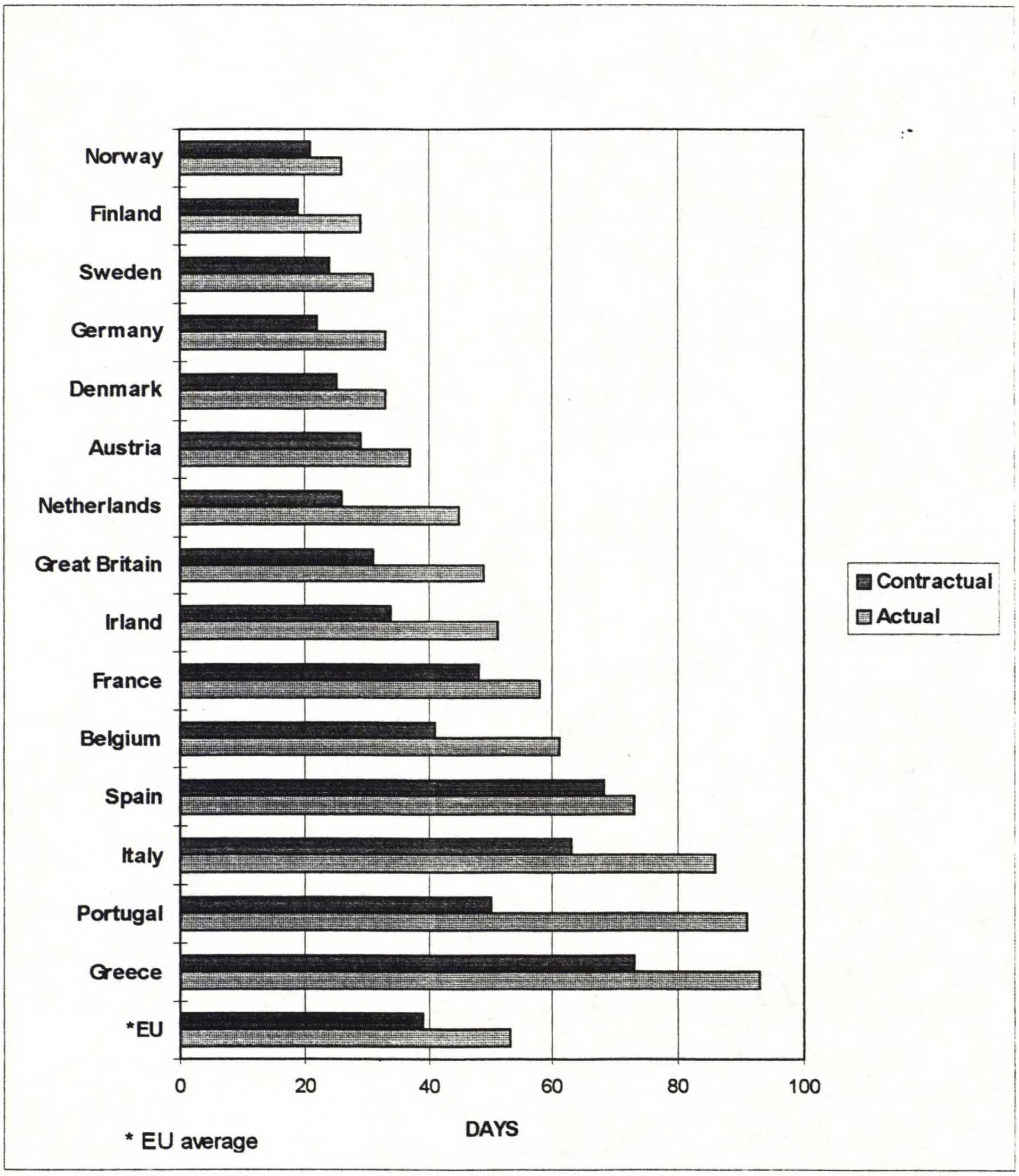
3.1 Cultural differences

There are substantial differences in business manners in different countries. A group organizing its international cash management has to be aware of foreign business cultures and to use local subsidiaries' (and banks') knowledge on payment practices etc. Hedman writes that the key concerns of cultural differences in cash management are payment moral and personal relationships (Hedman 1992, 162-163).

3.1.1 Payment moral

According to Hedman (1992, 163) the payment moral is highest in Scandinavia and lowest in latin and Asian countries. In Scandinavia invoices are expected to be settled latest two days after the due date; in latin countries getting paid already shows high moral itself while the timing is not that important. The Commission of European Union has studied the average credit times in EU-countries and the results were clear: there is a significant gap between the north and the south in both agreed and actual credits. The average actual credit times can be anything from 20 days in Scandinavia to 90 days in Italy and Greece (Puustinen 1997, 11). Similar results can be found in the survey carried out by Merita Bank (Merita 1997, 21-23). The message of the article was that despite the possible success of the EU in implementing the Single Currency, the member countries will still have completely different rules in the field of payments. The Commission has recogniced the problems related to this "payment jungle" and is already preparing a Directive on the matter (The Commission of European Union 1997, 11)

Figure 6. Average credit times in The European Union



Source: The Commission of European Union (1997, 11)

The payment moral is one of the biggest challenges of Finnish cash management in international business. Long credit times outside of Scandinavia make it even more important to secure an efficient transfer of receivables into the proper accounts. Cultural adaptation is often needed but all unnecessary delays, from buyer's as well as bank's side, should be studied and rooted out.

3.1.2 Personal relationships

Personal relationships, also, seem to have more importance in southern cultures than in north. For example, when there is a case of payment collection, it facilitates the situation if the parties have well established personal connections. Personal honour and pride are given a lot of stress (Hedman 1992, 163). Good relationship is one way for a Finnish company to get better treatment also from cash management's point of view. Building of a strong long-term relationship may take time but it can contribute to important cost savings, especially in foreign cultures.

3.2 Governmental and legislative issues

An international environment imposes significant restrictions on the idea that funds may easily and without cost be moved anywhere in the world. Political, tax, and foreign exchange considerations are to be taken into a account when organizing the cash flow systems in foreign countries (Eiteman & Stonehill 1989, 549-551).

Foreign country's governmental policies may change so that the operative environment of the company changes. A more tightened currency regulation, devaluation decisions, altering of the legislation concerning international funds transfers, for example restrictions in dividend payments from subsidiaries to the parent, and all kinds of social turbulences (war, riot, revolution, etc.) may result in a diminuation, delays or a blockage of cash flows (Kytönen 1993, 26-27, and Madura 1990, 480-481). Also, certain cash flow optimization techniques may not be allowed in some countries, for example multilateral netting (see Chapter 2.4.4) is not possible in Italy, Spain and in South America (Hedman 1992, 117). Benefits from a presence in foreign countries may arise in the form of lower taxes or favourable foreign exchange rates.

3.3 International banking environment

3.3.1 Motivation for international banking

The creation and growth of international banking is largely attributed to the growth of international business. Deregulation of international financial markets has enabled also smaller companies to benefit from a larger variety of financing tools.

Madura (1990, 566) presents four motives for banks' global expansion and those motives can be regarded as driving forces for international companies as well. Firstly, a portfolio of international loans is not expected to be as susceptible to a single economic event as a purely domestic loan portfolio. The argument here reflects benefits of international diversification. An MNC should consider establishing business in several countries in order to prevent from being vulnerable to a particular economic event. Secondly, foreign banking markets may have easy access to entry. Regulations may be more relaxed in one country and more tight in another, for example in The United States the banking system is very restricted compared to Euromarkets. Thirdly, economies of scale (lower average cost per unit of output as volume increases) may result from international expansion of banking services. Cost reductions enable banks to offer companies more interesting contracts. And finally, subsidiaries of MNCs located in foreign markets may request services from the banks which the headquarters use in the home country. Thus, the establishment of foreign branch banking can further develop relationships already initiated with MNCs.

3.3.2 Payment systems

In order to understand the international payment environment as whole, this section describes the prevailing wholesale payment systems and their future outlook. At the end, there is a brief overview to the banking conditions in selected countries (the ones used also in the case-study).

3.3.2.1 Wholesale payment systems

The volume of transactions in national and international financial markets has been growing tremendously during the past 10 years and this has produced a corresponding increase in payment flows (see Figure 7).

Figure 7. Development of settlement flows

Settlement flows are huge and growing [1]
(billion dollars)

	1988	1990	1992
France			
Paris clearing house	77.2	94.1	97.0
SAGITTAIRE	8.7	26.0	44.7
Banque de France credit transfer system	20.9	27.2	32.1
Germany			
EAF (daily electronic clearing)	--	61.9	212.9
Daily local clearing	171.7	213.3	142.0
EIL-ZV (intercity credit transfer system)	10.0	20.7	34.9
Local credit transfer system	15.3	20.8	21.6
Italy			
SIPS	--	18.8	38.9
Electronic Memoranda	--	17.2	33.9
BISS [2]	4.0	5.5	9.3
Japan			
Bill and check clearing systems	124.6	132.4	112.6
Zengin	39.8	51.6	54.5
FEYCS	117.2	200.4	196.1
BOJ-NET	692.8	1,017.9	1,133.8
Switzerland			
SIC	69.0	87.5	95.1
United Kingdom			
Town clearing	54.8	34.1	9.8
CHAPS	80.4	134.9	147.9
United States			
Fedwire (funds)	640.0	796.4	796.8
Fedwire (securities)	367.6	399.6	558.8
CHIPS	661.6	888.4	953.2

Source: Bank for International Settlements, 1993, *Payment Systems in the Group of Ten Countries*, Basle.
Note: EAF: Elektronische Abrechnung mit Filetransfer; EIL-ZV: Eiliger Zahlungsverkehr; SIPS: Sistema Interbancari di Pagamenti; BISS: Banca d'Italia continuous Settlement System; Zengin: Zengin data telecommunications system; FEYCS: Foreign Exchange Yen Clearing System; BOJ-NET: Bank of Japan Financial Network System; SIC: Swiss Interbank Clearing System; CHAPS: Clearing House Automated Payment System; CHIPS: Clearing House Interbank Payment System.
1 Daily payment flows.
2 This system also handles payments between banks and the Banca d'Italia or the Treasury, which are settled across centralized accounts held at the Banca d'Italia.
-- Indicates not yet in operation.

Source: Folkerts-Landau & others (1997, 25)

These flows are facilitated by an interlocking network of wholesale payment systems that is at the core of world's major financial systems. Basicly, there are two types of wholesale payment systems: net periodic settlement systems and real-time gross settlement (RTGS) systems. Each is associated with particular risk control measures. A bank's exposure to settlement risk is eliminated once it receives payment in central bank funds - so called good funds. So, the crucial determinants of settlement risk are the size of a bank's exposure and the time lapse between sending a payment instruction and final settlement (Folkerts-Landau & others 1997, 25).

Net periodic settlement

In net periodic settlement systems, participants send payment instructions to each other over a given period of time, which are settled at the end of the period on a net basis. As there is no guarantee of their completion until settlement, payments become final only after settlement. Settlement is typically not achieved before the end of the day.

Large-value netting schemes usually employ multilateral netting, in which the net amount of a bank vis-à-vis the clearing group as a whole is calculated. Netting significantly reduces the need for "good funds", because transactors need only have a sufficient volume of the settlement medium - reserve balances at the central bank - to cover net amounts at the end of a settlement cycle. But netting arrangements expose the participants to risk as they extend large volumes of payment-related intraday credit to each other. This credit is the "lubricant" of the financial system: it represents the willingness of participants to accept payment messages on the assumption that the sender will cover any net debit oblication at settlement. The settlement of payments, by the delivery of reserves at periodic (usually daily) intervals, is therefore a key test of the solvency and liquidity of the participants.

The most serious risk in netting systems is the risk that the failure to settle by one participant will lead to a system crash. Recognizing the risk, the central banks of the G-10 countries (the United Kingdom, The United States, Canada, Japan, Germany, France, the Netherlands, Belgium, Italy and Sweden) have formulated minimum standards for netting schemes. These so-called Lamfalussy standards stress the legal basis of netting. In addition, netting schemes should include adequate procedures for the management of credit and liquidity risks. One way to contain such risks is to set limits on the size of each participant's net debit position. In addition, netting schemes should have a reserve fund to complete settlement if a large participant does not meet its oblications. (Folkerts-Landau & others 1997, 25-26)

Real-time gross settlement

In RTGS systems, each payment is immediately settled on a gross basis. Settlement in all major wholesale payment systems occurs on the books of central banks. The direct finality of gross settlement prevents settlement failures, with their potential systemic consequences. In some RTGS systems, the central bank grants daylight overdrafts to the participating banks by guaranteeing all outgoing payment instructions, thereby preserving the liquidity and the processing efficiency of net settlement systems. Participants can make payments throughout the day and have to erase their overdrafts only at the end of the day. In the absence of collateral for such daylight overdrafts, however, the central bank assumes credit risk until the overdrafts are eliminated. Collateral requirements, or even the more stringent prohibition of overdrafts, minimize credit risk, but they also may significantly reduce the liquidity of the system. If good funds or acceptable collateral are not available, payments could be rejected or at least delayed until cover is obtained. (Folkerts-Landau & others 1997, 26)

The future outlook of wholesale payment systems

It seems that the grand majority of the central banks are in favour of RTGS systems for wholesale payments. Three factors have led to this direction. The first is the fast-growing volume of payments that has resulted in massive intraday credit exposures between banks. Some European central banks would like to remove interbank payments-related credit from the payment system altogether. The second factor is the doubtful legal status of netting in some countries. And thirdly, RTGS systems offer an opportunity for real-time delivery-versus-payment (DVP) settlement for securities transactions. Most European countries have introduced real-time book-entry systems for the transfer of securities. Recently, The European Monetary Institute published a blueprint for the new payment system for the single currency to be introduced on January 1st, 1999. The new system, called TARGET (Trans-European Automated Real Time Gross Settlement Express Transfer), will build upon national RTGS systems and provide an interlinking mechanism (see also Chapter 3.3.6.2). (Folkerts-Landau & others 1997, 27)

Cash management and payment systems

Having a macro-economic nature the wholesale payment systems may seem quite irrelevant from a company and cash management perspective. However, some important links to corporate cash management can be found. Firstly, commercial (retail) banks are working in close cooperation with central banks in the process of payment system restructuring (Folkerts-Landau & others 1997, 25). Secondly, it may be possible to use TARGET system also for execution of high value commercial payments (see also Ch 3.3.6.2). And thirdly, in the horizon there is an increase of national RTGS systems. At the moment, only a few commercial banks are members of more than one system, but the number of such banks is likely to grow (Folkerts-Landau & others 1997, 28). All the issues mentioned above may give important additional thinking for the responsibles of corporate cash management. When evaluating the banks for cash management, it may be worthwhile to investigate the technical capabilities of those banks, how well they are integrated to the existing wholesale banking and what is the degree of their knowledge concerning the future payment systems.

3.3.2.2 Banking conditions in selected countries

This section gives an overlook to the banking environment of some major industrialised countries. These countries were also examined in the empirical study. The aim is to show how different the international banking conditions can be from the cash management point of view. The source used was Back 1988, 142-168, with some modifications by banks in those countries.

AUSTRALIA

Central bank, regulatory and monetary control

The Reserve Bank of Australia, the central bank, supervises the regulatory banking framework in Australia. The central bank's role is to be the issuer of notes and to supervise the banks based on the assessment of the adequacy of management systems regarding the risk exposure, on capital adequacy criteria and similarly liquidity adequacy, and on monitoring off-balance-sheet activity. The Reserve Bank maintains close ties with its co-central banks around the world, particularly with regard to monitoring prudent banking practices.

Clearing system

This is similar to other payment clearing systems, where net interbank balances are settled through the central bank. There is a growing tendency to move to paperless transfers. Automated payments by the consumer as well as the business user are more widespread. This has been a feature of cost and geography.

Until late 1980's the Australian wholesale market was largely domestic in its orientation. Internationalisation has introduced new authorised banks, and a futures exchange and commercial paper market have been set up to increase liquidity and depth in the wholesale market. The primary instrument is still the bank bill, upon which most lending is based, but the straight loan market is being established on the back of the developing interbank market, Most consumer and corporate short-term credit is handled on overdraft accounts through the main retail banks.

Exchange control

There are no exchange control restrictions.

GERMANY

Central bank, regulatory and monetary control

The Deutsche Bundesbank (Buba) is the central bank of Germany. Its head office is in Frankfurt with a main branch in each of the states, known as Landeszentralbanken, and several hundred branches throughout the country. The Bundesbank acts as sole issuer of banknotes, intermediary for interbank transactions, lender of last resort, and banker to the government. Its main task, however, is to regulate the monetary supply in order to maintain the value of the Deutchmark and the amount of credit available in the banking system.

Clearing systems

The bulk of domestic clearing, remittance and bill collection is settled through the Bundesbank and its branches. In towns where there is a branch, local daily clearing is offered whereby the Bundesbank branch determines the clearing balance of each bank and debits or credits its central bank account as appropriate. Where institutions do not take part in the local clearing, transfers between Bundesbank branches are arranged. The central bank automated giro system can be used to access any bank in the country. There are similar giro networks set up by the savings banks and co-operative banks. Payments are typically cashless, in the form of direct debits or credit transfers. Cheques are not as popular in Germany as for example in Great Britain. This is partly due to the preference for credit transfers.

The structure of German banking is a mixed one, having developed over time. As mentioned above, the centre of the system is the Bundesbank and Landeszentralbanken. Then there are specialist and retail banks, differentiated according to the type of service they offer to their customers and the types of deposits they attract. The larger sector of multi-purpose banks are of three types: commercial banks, including the foreign and regional banks; savings banks (Sparkasse) and their central institutions (Girozentralen); and co-operative banks, with their central institutions being either urban (Volksbanken) or agricultural (Raiffeisen) based.

Exchange control

There are no exchange control restrictions.

THE UNITED KINGDOM

Central bank, regulatory and monetary control

The central bank of the United Kingdom is the Bank of England. It regulates the banks, and acts as banker to the government and private-sector. It has responsibility for day-to-day supervision and control of the foreign exchange and money markets. The Bank of England also supervises the banks by monitoring their ongoing liquidity in capital adequasy ratios. The guidelines as to what constitutes prudent levels are revised from time to time, in conjunction with those of other central banks to ensure a similarity of approach. These measures are being extended to include off-balance-sheet items, which can greatly affect a bank's overall exposure profile.

Clearing systems

The clearing banks are members of the clearing houses for cheques and money transfers. Any other institution is obliged to clear its cheques and transfers through a clearing bank acting as an agent with the Bank of England. The London clearing banks stand at the heart of the banking system. Couple banks in Scotland and Northern Ireland perform the same function in their jurisdictions.

The clearing banks have a large retail network through which they take in deposits, make loans and transfer money on their clients' behalf. There are different types of account that a customer may have for depositing or borrowing funds. The most common is the overdraft account, with a negotiated borrowing limit to it. Cheque payments are still very popular in the United Kingdom. More expensive method is CHAPS payment (Clearing House Automated Payment System), a private network system developed for transfers of higher value items. For mass payments, such as salaries, companies can use also a private network, so called BACS transfers, with lower charges.

Exchange control

There is a free exchange of sterling into and out of the country.

THE UNITED STATES

Central bank, regulatory and monetary control

The United States has a structured and complex banking system. US banks can apply for a charter under federal or state law. State chartered banks are monitored by the state banking authority, while the federal banks are overseen by the Office of the Controller of Currency. The Federal Reserve has specific responsibilities in monitoring its licenced member banks (both state and federal) and US bank holding companies. Banks apply for membership of the Federal Reserve in order to be part of the clearing system and have access to Fed Funds (same-day funds). The monetary control is maintained by the Federal Reserve System. The New York Federal Reserve Bank, or "Fed", acts on behalf of the US Treasury and foreign official institutions. It also acts as a "lender of last resort" to commercial banks.

Clearing systems

Cheques are the most common form of payment instrument in use. As a consequense an elaborate, nationwide cheque clearing network exists to guarantee rapid and efficient processing.

One of the latest developments in the cheque collection has been a so called *lockbox*. The aim is to accelerate the depositing of funds by sending items straight to the bank and not to the company (cf. Ch. 2.4).

Wire transfers are generally used to settle high-value items on a same-day value basis, for instance in securities settlements. The cost of transfers tends to be high but this is offset by the quicker funds availability. Wires are initiated by telephone, telex or via a special terminal by the customer to the bank. The bank will transmit the transfer either by Fed wire, CHIPS or SWIFT to the receiving bank, which will in turn credit the company account holder and notify them of a receipt into their account. Fed wires are used for domestic transfers. It is a Federal Reserve sponsored network. CHIPS (Clearing House Interbank Payment System), on the other hand, is a private network involving over hundred financial institutions, allowing transfer of funds within member banks' accounts. Final settlement is through Federal Reserve accounts. It is operated by the New York Clearing House Association. The third network is SWIFT (Society for Worldwide Interbank Financial Telecommunication), which is an international network used to send standardised transfer instructions from one bank to another.

Electronic payments. Money can be moved electronicly through the Automated Clearing House (ACH). The payment company initiates instructions to the bank using a special terminal or a magnetic tape. The local Federal Reserve Bank processes the transactions.

Exchange control

There is none in existence regarding the exchange of the US dollar for capital or trading purposes.

3.3.3 Payment methods

The business arena an international group faces is more complex and the cash management more challenging than that of a domestic company and therefore, the variety of payment methods is larger as well. The methods can be divided into three group: clean payments, collections, and letters of credit (L/C) (Larsson 1991, 36-38).

Clean payments

Clean payments are the normal ways of payment in well established business relationships in developed banking infrastructures (North and Central Europe, USA and Canada). The payments can be made by:

a) Payment order. The buyer instructs his bank to credit the seller's account. This is done by means of SWIFT (Society for Worldwide Interbank Financial Telecommunications), which is an electronic way of transferring the funds from one country to another. This method takes (or should take) normally two bank days.

b) Bank draft. A debtor buys a bank draft (a cheque drawn buy the bank against its own funds) and uses it to pay a creditor who may not accept a personal cheque.

c) Personal cheque. The drawer is an individual firm who has a checking account with the bank. When making payments in foreign trade, personal cheques should be avoided because there is no guarantee of cover.

Collections

Clean payment transactions involve considerable risk of non-payment. The seller can reduce the risk by sending the business documents through banks. The buyer's bank will release them to the buyer only a) against cash payment or b) against acceptance of a draft. This method is often used in new business contacts in Europe.

Letters of Credit (L/C).

In L/C transactions, the seller's risk of non-payment and the buyer's risk of non-delivery are minimized as a result of increased relience on bank services. The procedure in short is following:

- At the seller's request, the buyer instructs his bank to open a credit for a certain amount of money in the seller's favour.
- The opening of the credit means that the buyer's bank undertakes to pay the exporter provided that the exporter fulfills the terms of the credit as specified by the buyer.

Letter of credit is the most expensive method of payment. Unless otherwise agreed, it is the buyer who pays the bank charges. The seller, however, often grants a L/C discount towards the cost of the credit. (Höckerstedt 1991)

From the cash management point of view it is important that a L/C is required always when it is considered necessary. Basically this means all countries exept USA, Canada and Western Europe (Hedman 1992, 109). Even a L/C, however, is not a fullproof guarantee for fast and correct cash flows; lack of or errors in documentation may result in delays in release of money by banks, and that again builds extra costs for the cash management in terms of lost interests (Myllyperkiö 1995).

3.3.4 Retail banking

Traditionally so-called commercial (or retail) banks have offered the companies the necessary services for cash management. The future of international retail banking looks quite tempestuous. Major restructuring will face the industry all over the world and the number of banks, from which to choose the cash management providers, will reduce significantly (Ramsden 1997, 30).

3.3.4.1 Commercial banks

Commercial banks play a vital role in facilitating international transactions. They help organizing cross-border cash management systems and provide guarantees for international trade. They hold inventories of various currencies so a corporation can obtain the necessary currency to purchase foreign goods or invest in foreign securities. In addition, they offer forward contracts to corporations that desire to lock in the rate at which a currency can be purchased or sold in advance. Commercial banks also provide loans to corporations in various countries (Madura 1989, 566). Some examples of international commercial banks are Merita, Skandinaviska Enskilda Banken, Commerzbank, etc.

3.3.4.2 Global banks vs. international banks

According to Morgan Stanley (1996, 2), a change from local to global is evident in banking business. Global banking is actually becoming a global wholesale financial service - the integrated delivery of financing and advisory services, sales and trading, asset management, and transaction processing, states Morgan Stanley. "This emerging global industry is dominated by large, worldwide firms, many of which have commercial banking origins. Regulatory frameworks that once separated capital markets activities from commercial banking and insurance are obsolete, and a group of big companies with substantial geographic and product breadth has emerged to the banking world, eg. Chase Manhattan, Citibank and Deutsche Bank" (Morgan Stanley 1996, 2).

Large (1997, 28) defines a global bank as follows: "...A truly global network bank is one with facilities in all major continents, is a significant player in the major currency centres, provides a full range of services and products in each of its branches, and has a network of experienced and capable staff to provide global solutions locally, their objective being to provide services wherever they are needed". International banks are typically large domestic banks that support their local customers when they carry out international business. They may have a presence in one or two of the major financial centres and from these and their domestic bases transact business globally for their customers. They have to rely on alliances and correspondent banks to provide the full global coverage. (Large 1997, 31)

Large (1997, 30) argues that in the next ten years a small number - probably no more than five - of truly global players will capture up to two-thirds of corporate cross-border business. According to Large, some of the smaller banks, however, will fight back, and one sign of this is so called payment/banking clubs, that is partnership alliances formed by some international banks. The main strength of these clubs lies in the strong local presence in member bank's home countries. An example of this type of international banking is Girobank and its Eurogiro system. It links the computer systems of the member banks (Giros) so that the cash flows can be transfered to giro and bank accounts in other countries quickly and cost-effectively. (Large 1997, 30)

An important remarque to the development of retail banking can be found in the article of Ramsden (1997, 30) where he goes slightly deeper into the question of profitability versus size. He points out that "...although processing large volumes of transactions leads to economies of scale, these are often outweighed by the diseconomies created by: the size of branch networks (and the added management complexity and overhead), the size of the product set, which both increases management effort and results in the cannibalisation of customer bases (i.e., moving customers between products) and lack of focus, and the costs of supporting and refreshing the large IT (Information Technology) infrastructure necessary to support extensive product, customer and branch operations..." (Ramsden, 1997, 30). This can be interpreted so, that also large banks will have to make careful feasibility studies in order to survive and a well-organised segmentation, once again, may be the key to success.

3.3.5 Bank relations

A company which have existed for a long period of time and have experienced an important growth and internationalization might have neglected the study of its bank relations. When the company started its international operations and chose the banks it perhaps used such an evaluation criteria as "good coverage" or "easy access for clients" etc. "Becoming an international group with more complex organizational structure requires to see if the bank relations built some 50 years ago are still as suitable as they should for the whole group" (Suuraho 1997). Today's corporate banking sector is expected to meet the various needs of international groups and provide them reliably and efficiently. Services such as cross-border payments, value-date practises, cash pooling, overdrafts, electronic banking, netting, factoring, etc. are to be studied by the cash management. Naturally, long term finance and risk management will be involved when making final decisions on group's global bank relations.

3.3.6 EMU and cash management

The following section will illustrate the (possible) effects of the Single Currency on cash management and it is based on several articles taken from the material which was given by the banks involved in the case-study. In many cases the banks are working together on these issues and therefore, the ideas are highly similar in different texts. While references to a single source would have been misleading it felt more justified to present a complete list of sources only at the end of the section.

3.3.6.1 Impact of the euro on corporate cash management

a) Improvements

Local accounts will still be vital in most EMU-based cash management structures. These accounts may be resident or non-resident, in euro or national currency. Companies collecting receivables in different EMU countries will still benefit from local collection accounts that enable their customers to pay easily and cheaply to a local account number. This will ensure that the funds are received at the earliest possible point, maximising liquidity management efficiency, while minimising payment and collection costs, not only for themselves but also for their customers and suppliers.

Whatever their character or currency denomination, EMU-accounts will be able to be managed as one group (if concentrated in a European network bank). A European account structure can be set up with uniform conditions and uniform interest rates. EMU-wide facilities, such as credit facilities and investment arrangements, can be linked to these accounts. Legal requirements for account opening will, however, still differ by country.

Cash pooling will take more sophisticated forms. Within a country, accounts in different EMU currencies will be pooled, either notionally or physically (zero-balancing). Cross-border cash pooling facilities will be enhanced within the EMU. European network banks will provide different forms of cross-border pooling. Zero-balancing or target balancing schemes could be set up, whereby cash in euro and domestic currencies would be concentrated in a single account in one country. Notional cross-border pooling possibilities will increase, although legal and regulatory constraints will apply. Central banks will apply uniform reserve and solvency requirements, but positions will be reported on a country by country basis.

Centralized liquidity management will be easier in the EMU. Centralising cash positions physically on one location, or keeping balances local with local branches of one European bank, will avoid idle balances. EMU's large and liquid money market will offer extensive trading opportunities.

Foreign exchange management will be simplified. Once FX-rates have been fixed irrevocably in January 1999, foreign currency risks and conversion costs will be eliminated for intra- EMU trade. In addition, uniform and extended opening hours (7 a.m. -6 p.m. CET) of the national RTGS centers (Real Time Gross Settlement) will allow the money market to be open all day.

Transaction services will be improved, although traditional cross-border transfers will not be similar to domestic transfers. High value payments will become real-time, helping companies gain full control over their balances and key transactions. Low value payments will become more efficient, especially if they are routed through banks with clearing connections in all EMU countries.

Information provision for treasury and administration will be enhanced as well. At some point after the introduction of the single currency, cash managers will receive from their main banks real-time information on balances and important transactions. Treasurers and controllers will be able to receive more and consistent information on the companies' financial activities if transactions are concentrated with a pan-European bank. With more clearing houses adopting EDI-standards (Electronic Data Interchange), information on transaction details will be extended.

b) Constraints

Low value payments - many payments today are cleared through lower value systems, such as BACS in the UK. Little official attention has been given to the possibility of creating one similar system for the EMU environment.

Central bank reporting will remain an obstacle for cross-border transfers. Central banks are currently not expected to remove the reporting requirement for international transactions needed for their national statistics. So the distinction between resident and non-resident accounts will remain.

Liquidity and solvency requirements will be uniform for all countries, but positions will be measured and reported on a country-by-country basis.

Differences in insolvency laws between countries will apply.

National tax jurisdictions, withholding tax, capital gains tax - national tax jurisdictions will create important obstacles for a truly European cash management. Inter-company transfers between countries, therefore, must be accounted for at arm's length. Some countries apply witholding taxes on interest payments, while others don't; some countries apply a special tax rate on capital gains, while others don't. These constraints will hinder cross-border credit and pooling arrangements. Organisations need to investigate the legal and tax implications in all cases.

3.3.6.2 Cross-border payments within the EMU

a) "High value" payments

■ **TARGET** (Trans-European Automated Real-time Gross settlement Express Transfer system):

In January 1999 the central banks will implement a new clearing mechanism called TARGET. This pan-European clearing system will clear euros across the banking industry. The system is designed for "high value" payments such as:

⇨ Open-market and other monetary transactions by the European System of Central Banks (ESCB)
⇨ Settlements of financial transactions between the commercial banks
⇨ Payment transactions by the commercial bank's customers

The central banks are setting up the TARGET system to enable the execution of a single monetary policy and to ensure a single money market rate in all countries. The system includes two main components:

• A Real Time Gross Settlement (RTGS) system in each country, which processes transactions in euros on a one-by-one basis. Funds will be transferred immediately and credited irrevocably to the account of the beneficiary bank.

• An interlinking system between the national RTGS system and the European Central Bank, enabling transfers between banks located in different countries. These transfers will be guaranteed within a half hour, but in practice they will be executed within seconds.

In the discussions between the central banks, important issues remain to be solved. One is the pricing policy. Will the central banks apply a common end-to-end price for cross-border transactions through TARGET? Will European antitrust law allow such a common price? And will the central banks, who operate their national settlement systems at different costs, be able to agree on this price? Central banks have announced to be striving to cover their investment and operating costs. On this basis, experts in the payment industry expect the price to be somewhere between 2.5 and 6 euros (USD 3-7). Because commercial banks must cover their costs, as well, customer fees could be well above this level. TARGET, therefore, will most likely be too expensive method for low value transfers.

Another important issue is the position of EU members that may choose not to join the EMU in the beginning, such as the UK. Will the UK banks using the euro clearing have access to intra-day credit facilities? This issue still has to be solved by the central banks. Intra-day credit is necessary to guarantee immediate execution of payments.

b) "Low value" payments

■ **Correspondent banking**

For the majority of banks within the EMU, correspondent banking will remain the prevailing method for processing cross-border payments. Such processing is relatively expensive and slow, because each payment passes through different banking institutions whose processes have generally not been highly integrated. SWIFT (Society for World-wide Interbank Financial Telecommunications) and its member banks are making efforts to be able to offer more consistent and less expensive service. Currently SWIFT is adjusting its message formats to facilitate euro and national currency payments.

■ **EBA clearing**

The ECU Bankers Association (EBA) operates a processing centre for ECU transactions between 49 major clearing banks. The EBA has launched an initiative to transform the ECU clearing into a euro payment system by 1999. Exept for mass payments, such as payroll payments and direct debits, the new clearing system will handle most types of payments. Payments will be processed the moment they reach the clearing centre, but the final settlement will take place at the end of the day. The EBA expects the cost structure to be significantly less expensive than other systems due to its simple end-to-end design and the use of existing SWIFT-based technology.

One disadvantage, however, will be that only EBA member banks will be able to exchange payment messages directly. Payments to and from non-member banks will require additional effort, which will increase costs and make the service less consistent.

■ **Network banks**

European network banks with branches in all EMU countries will use their own networks and local clearing links to offer a wide range of payment services. They will be able to handle bulk payments, individual cross-border payments and real-time payments. Because they are not dependant on other banks, they can guarantee a consistent service level in all EMU countries. Additionally, they will be in a position to offer local account and payment services in conjunction with EMU-wide cash management services. The charges are, naturally, to be compared by the customers.

c) Directive 97/5/EC of the European Parliament and of the Council on cross-border credit transfers (Jan. 27th, 1997)

■ to improve the services related to cross-border payments within the Union
■ applies to credit transfers of less than ECU 50 000

The content of this Directive in short is following:

• both the originator and the beneficiary of the payment have to be aware of the total cost of the transfer before the execution
• unified minimum requirements concerning the payment instructions and information
• the maximum time taken by the banks to make the transfer: the date of acceptance of the payment order + five (5) banking days
• where the agreed time limit is not complied with, the beneficiary's bank shall compensate the beneficiary (interest included)
• no compensation shall be payable if the beneficiary's bank can establish that the delay is attributable to the originator or its bank

(Official Journal of the European Communities 1997)

For corporates, especially the North-European companies, a harmonisation of payment practices within the EU would be a big relief. However, due to the cultural differences discussed earlier, there are great doubts in banking world about the success of these type of institutional rules, or at least it will not happen overnight.

Sources (the latest publications of selected banks about the EMU and cash management):

ABN AMRO (NL)
Bank of England (GB)
Barclays Bank (GB)
Citibank (US)
Commerzbank (DE)

Hambros Bank (GB)

ING (NL)

Kredietbank (BE)

Merita Bank (FI)

National Westminster Bank (GB)

Postipankki Oy (FI)

Rabobank (NL)

3.4 Selecting the evaluation criteria

It is difficult, or even impossible, to determine standard criteria in the evaluation of cash management banks. Companies' interests and needs may vary considerably and accordingly, the best possible banking set-up should be studied case by case. In literature there is no straight answer to the question: "How to evaluate banks from cash management point of view?". Therefore, the empirical part of this study is based rather on practical company considerations than on theories in the literature.

Naturally, when thinking about banks' cash management services, some general criteria for the evaluation process can be found. Cost, effeciency, reliability and information could be examples of key issues in international cash management. But a more detailed list of criteria is needed depending of the company stucture and the countries in question. Some criterion may be completely irrelevant in one country whereas in another country it could be regarded as a decisive element.

To find an optimal solution the qualitative factors should not be neglected. Membership in local clearing system, strategic value of cash management for the bank, bank rating, innovativeness and future outlook of the bank are just some of the quality issues influencing the banking decisions of an international company. It is then up to company management to decide which factors are the most crucial ones.

In this point it is important, however, to remind about the other side of the coin, namely the overall bank relation of the company. It seems that both from company and bank perspective cash management is regarded as a package, which is given to banks who are willing to participate in long term financing, e.g. syndicated loans, of the company. Additionally, important existing loan agreements and treasury operations, e.g. foreign exchange deals, may play a major role when making any banking decisions. All this leads to a fact that whatever the outcome of an evaluation process is, cash management alone is hardly ever the only factor influencing the final bank choises.

3.5 A Finnish point of view

In Finland (and in Scandinavia) the bank systems are probably the most developed in the world. The coverage of domestic networks is very high and connections between different commercial banks are working well. In addition, high quality ADP (Automated Data Processing) programs provide companies with good possibilities for electronic banking. Therefore, organising an efficient <u>domestic</u> cash flow management in Nordic countries is fairly unproblematic. An MNC, however, faces a completely different arena when it looks at the servicies and efficiency of the overall banking system handling its international cash flow management. A Finnish internationally operating group has several banking alternatives to take care of its bank transactions:

a) A Finnish bank. It is highly unlikely that a Finnish bank located in Finland would be the best solution for an international group.

b) A Finnish bank with its foreign branches. The Finnish banks and their foreign branches are probably too small and unknown to be able to handle the whole business of the group.

c) A local bank. Local banks are often needed as the clients may prefer paying in their own currency in their own bank. The quality of local banks is varying and especially in Southern Europe a special attention should be made when deciding the bank connections.

d) A third country bank. Swedish commercial banks, for example, are actively providing their cash management servicies to Finnish companies. A question arises: are they internationally big enough/known enough, and how good are their foreign partnership banks in handling local cash flows?

e) Multinational/global banks. The real benefits of bank's multinationality has to be studied in detail. Does the size bring efficiency or inefficiency? A group should also carefully define its position and importance to the bank: is it an important customer or perhaps just a small piece in a big play? There may lie considerable risks in giving a major part of the business to only one multinational bank.

f) Some kind of a combination of all above?

To make the best selections among the commercial banks available requires careful studies and one example of an evaluation process is presented in the following chapters, namely the case-study.

3.6 Theoretical framework

Figure 8 pulls together all elements discussed in previous chapters and forms a theoretical framework for the empirical part. The aim of Figure 8 is to illustrate the factors influencing bank evaluation from international corporate cash management perspective.

Figure 8. Theoretical framework: Factors affecting bank evaluation from international corporate cash management point of view

MICRO ISSUES ⟺ **MACRO ISSUES**

Company considerations

BANK RELATIONS

⇒ Growing number of banks and accounts
⇒ More and more complex banking network?

FOREIGN SUBSIDIARIES

⇒ Centralized or decentralized cash management?
⇒ Different CM techniques available accordingly
⇒ Maintaining of motivation

OVERALL FINANCIAL STRATEGIES

⇒ Short-term vs long-term strategies
⇒ Growth requires reliable relationships with financial institutions; "the other side of the coin"

Environmental effects

GOVERNMENTAL AND LEGISLATIVE ISSUES

⇒ Political, tax, and foreign exchange considerations
⇒ Differencies in possibilities to use certain CM techniques

CULTURAL DIFFERENCIES

⇒ Payment moral
⇒ Personal relationships

INTERNATIONAL BANKING ENVIRONMENT

⇒ Future development of wholesale banking
⇒ Retail banking:
- • CM services
  - technological capabilities
  - wideness of service selection
  - costs (incl. value dates)
  - network
  - quality of service
- • Future outlook (strategic fit)

⇒ EMU: threaths or possibilities?

4 RESEARCH METHODOLOGY

The fourth chapter highlights the methodology behind the empirical part of the research. Issues concerning the selection of a research method and a case company, data collection and analysis as well as validity and reliability of the study are discussed.

4.1 Research approach

Within the range of research methods several possibilities can be found to conduct a study on bank evaluation. A quantitative study with a large survey could be one alternative. Questionnaires could be posted to several companies and banks. This method would provide with a lot of information on different companies/banks but the qualitative side would be quite lightly treated. Additionally, the nature of the topic would most certainly prevent from getting classified information from all companies and banks and the comparisons would be quite artificial. According to Yin, a survey is a relevant method to a study with research questions like ”who”, ”what”, ”where”, ”how many” and ”how much” (Yin 1988, 17).

In this study, case study method was selected to be the research strategy. The case study is the most preferable research method when a ”how” or ”why” question is being asked about a contemporary phenomenon within some real-life context, and the investigator has little or no control over events (Yin 1988, 13). There are, however, some constraints related to the case study method. Lack of rigor, little basis for scientific generalization and a long research period resulting massive, unreadible documents are among the most common accusations against this method (Yin 1988, 13-22).

To justify the choise of the case method the author would like to point out the ”how” nature of both subquestions which eventually influence the main research question to a great extent. Additionally, in order to get the best possible results, the author felt necessary to use all the tools the case study method allows namely interviews, surveys, observations and filed documents. Due to this, the research can be regarded as a combination of qualitative and quantitative data. Finally, the choise of only one case company can be justified by the nature of the data; it would be very difficult to get classified information from several sources and missing this would have changed the purpose of the study - understanding of real-life events - quite completely.

4.2 Selection of a case company

As a former employee of the case company the author of this study was given a chance to investigate the banking situation of the company in selected countries. While familiarizing with the assignment it became clear that the cash management issues related to bank evaluations had not been studied to a large extent and the topic would certainly be of academic interest as well. Access to all company information, not to mention the funding for the visits to the countries in question, was an important asset in carrying out this research. The case company benefits naturally from the author's existing knowledge and relationships in the company; the work was easier to explain and faster to complete.

4.3 Data collection

4.3.1 Data collection at Case Company

A quite thorough acquaintance with the company history was needed in order to understand its banking relations and therefore, a familiarization phase was necessary. A primary source of information was the Finance Department at head-office. Data was collected by doing observations and open interviews and by going through group accounts, old files and contracts.

Another important source of information were the foreign sales offices and production facilities. An internal inquiry concerning the cash management issues and the banks was sent to nine managing directors in nine countries (cf. Appendix 1 for the internal inquiry). Additionally, a number of visits were made to selected countries to interview company people responsible for cash management and bank relations. The interviewed persons were normally the Managing Director and the Financial Manager/Chief Accountant (cf. Appendix 2 for an example of the agenda in these meetings). The purpose of these visits from company perspective was not just informative but also, to motivate foreign subsidiaries to understand and accept the possible changes in Group banks. Therefore, the nature of the interviews was rather informal (open) and no tape recorders were used, only notes were taken. Having these meetings, instead of just relying on telephone discussions and faxes, proved to be a very important addition to the study. It became evident that people in all countries, especially in Southern Europe, are much more willing to share information in face to face situation than in telephone. Additionally, examples of account documentation were easier to find and go through in subsidiary premises.

Due to lack of time all countries involved in the study were not visited (the UK, the USA, Germany and Australia), and this did cause some problems in the analysing phase as well as in discussions with the alternative banks; the cash management situation in those countries did not become fully clear for the author before making the evaluations. The Managing Directors of all nine countries did reply to the internal inquiry, some of them after several notices, but the quality and the informativeness of the replies were quite variable. A more detailed description of the schedule of data collection is presented in Chapter 5.

4.3.2 Data collection from Banks

Data from existing banks was collected by investigating account information and old contracts at head-office. Missing information as well as updating were asked directly from the banks' cash management department and from sales offices by telephone or fax (cf. Appendices 3 and 4 as examples of numerous inquiries concerning the existing banks). Comparative information from alternative banks was gathered by sending a request for an offer to those banks, i.e. an open bid for organising Enso Group's cash management in those countries (cf. Appendix 5 as the request for an offer). After analysing these offers additional questions and clarifications were made to some banks by telephone and/or during a visit.

Besides of interviewing company people the visits to foreign countries included meetings with the alternative banks participating the bid, i.e. those who received the request for an offer. The meetings were organised at banks' premises and the participants were typically the author and 3-5 persons from the bank (cash managers, account managers, corporate banking managers, etc.). The discussions could be described being rather as business negosiations than interviews by nature and they were normally conducted in English. In Italy and Spain local help from the company was needed due to language difficulties. Within the discussions the banks were able to clarify theirs offers and to pose questions to the author about the Group and its cash management. They were also able to present some additional information about themselves and theirs services. From the author's perspective all these negosiations were truly interesting and the importance of the cash management as a new competitive service and a key to further relationship was easy to notice from the careful preparations and the senior staff presence in these meetings.

A total of 25 banks in nine countries were asked to prepare an offer for Enso Group and 25 offers arrived. Out of these 25 banks 16 banks in five countries were visited. Negosiations with the other banks were handled by telephone. Together with the existing nine banks the total sample amounted therefore to 34 banks in nine countries. A more detailed description of the schedule of data collection is presented in Chapter 5.

4.3.3 Data collection from other companies

Some of the tendering banks gave names of customers (references) who were willing to share theirs experiences regarding the cash management services of the bank in question. The cash managers of these reference companies were interviewed on telephone.

4.4 Data analysis

The data on existing banks collected at the Finance Department in Helsinki served as a base to the study. Tables were prepared on relevant issues such as charges, value dates, interest rates, etc. As already mentioned, the replies to the internal inquiry were quite variable and did not facilitate the study to a great extent. On the other hand, the interviews of company people abroad gave important additional information on the bank situation of the Group.

Offers from tendering banks were put into a form of tables by country and comparisons were made between the alternative banks as well as the existing banks. Besides of this quantitative analysis also a qualitative evaluation was made between the banks, and the results were summarized in a text part of each country. This qualitative section includes comments from head-office personnel (Finance Department) and local company people, the author's impressions and experiences at the bank meetings, and general knowledge gathered from mass media and publications. The evaluation of banks' Euro condition was based on the material (brochures, action plans, etc.) they sent and on the answers that were given in the offers and/or meetings. This was also commented in the text part of the end-report.

As already mentioned, some companies had accepted to serve as references for the bank. Interesting discussions came up with this possibility but since only three banks had mentioned reference companies in theirs offers and because of the reliability problem with this type of an information the data was regarded as of minor importance in this study.

An outcome of the collected and analysed data was then a list of recommendations for Enso Group's banks in nine countries. In Chapter 5 the findings of the study are presented and discussed in relation with the literature review.

4.5 Validity and reliability of the study

According to Uusitalo, validity means the capability to measure exactly the fact what was intended to be measured, and reliability means that the same results are reached when the measurement is repeated (Uusitalo 1991, 84). In this study the validity is secured by presenting the different phases of the research work in a chronological order and by showing the reader the data collection methods. Since the study was executed in only one company the reliability question can be regarded as the main problem of this research paper. No guarantee can be given that similar results would be gained if the study was repeated in another company or even in the case company. This is due to the fact that firstly, companies have different internal environments and secondly, companies as well as the business environment are in a constant state of change; reliable answers can only be given case by case. To increase the reliability of this work examples of the correspondence both within the company and to the banks were attached as appendices.

5 FINDINGS AND DISCUSSIONS

Besides of presenting the case company this chapter aims at describing a bank evaluation -project made for the company and finally, comparing the findings with the research questions and the literature review.

5.1 Case company ENSO GROUP: presentation

5.1.1 Company backround

Enso Oyj, with annual sales of FIM 28 billion and annual capacity of 6,7 million tonnes of paper and board (estim. 1997), is one of Europe's largest forest industry groups. Enso's core businesses are fine papers, publication papers and packaging boards, in which it ranks by capacity among the top three European producers. Exports and foreign operations total some 85% of Group sales. The main market is EU, which accounts for 76% of total exports. Within the EU the main export countries, depending on the product, are the UK, Germany, France and the Netherlands. Other important markets are East and Southeast Asia. Enso's products are sold through the Group's own international marketing network, which includes sales offices and representations in over 40 countries. Enso Group has over 19,000 employees.

During 1990's the Group has faced a rapid growth through acquisitions as well as greenfield operations. In 1992 the sales volume of Enso-Gutzeit Oy was around FIM 15 billion. Four years later, when Veitsiluoto Oy was merged to Enso-Gutzeit Oy and the company name was changed to Enso Oy (later Enso Oyj), the annual sales amounted to FIM 26 billion. In 1997 the figure is close to FIM 30 billion. After several incorporations in 1990's the Group consists now of a large number of domestic and foreign subsidiaries and the whole company map is quite complicated.

5.1.2 Existing bank relations

Enso's accounts in different countries have traditionally been opened at banks with a good network coverage and an easy access for customers. Some of the oldest bank relations have been established even 50 years ago. At those times the needs of the company were quite different than they are today. A rapid growth and incorporations in 1990's have led to a situation where nobody knows exactly the number of banks and accounts handling the cash flows of the Group and therefore, a rationalization study was justified

5.1.3 Cash management in ENSO GROUP

Cash management in Enso Group has both centralized and decentralized elements. In principle, the cash management responsibility is in the subsidiaries and the financial control together with the bank relations is centralized to the head office (Finance Department and Corporate Accounting). The subsidiaries take care of their receivable and make payments independently. The foreign exchange deals are handled with the Treasury Department at the head office. Enso aims at concentrating all excess cash on Group accounts and avoiding high positive balances on various subsidiary accounts. Small short-term credit facilities exist in banks in each country for urgent needs of local operations.

5.2 Planning and implementing a Bank Evaluation -project in ENSO GROUP

5.2.1 Backround

A significant growth and organizational changes within the Group have led to a situation where instead of having one account per bank some Group accounts consist of even 200 accounts and the biggest foreign currencies (GBP, USD) ca. 15 accounts. Enso's foreign subsidiaries bring their own "spice to the soup". The banks they have been using for years may not be perhaps capable to handle the increased flows efficiently and to provide with all necessary services, in other words, they are not ideal from the Group perspective. In many cases a long, personal relationship with the bank directors has facilitated the running of every day business, e.g. fast and cheap loans, customized service, etc. In these circumstances a resistance to a change of the bank is evident but without any truly justified reasons these personal relationships cannot overrun the policies and the benefits of the whole Group. This applies to foreign sales offices and agencies, as well.

Instead of looking for some sophisticated, global solutions for cash management, it was decided in the very beginning that the approach of Enso Group will be step-by-step by nature. First, it is important to rationalize the operations within the countries by getting all subsidiaries under the same Group bank and to establish local cash pools with the best possible conditions. And only after that it would be feasible to consider some further reduction of banks and maybe in the future to rely even to only one global bank. The chosen alternative banks in this study are all fairly large and well-known locally and/or internationally. In some cases the key consideration from the company point of view was the bank's potential for the long term funding in the future. Additionally, some banks were examined purely for benchmarking reasons, i.e. there was no real intention to change the existing bank but rather to get material for a renegosiation of the contract.

5.2.2 Present problems

The problem areas could be divided as follows:

- lack of coordination of internal cash surplus/demand of non-resident currencies in different companies and in different banks => inefficient use of internal cash resources (a lot of idle cash)
- a lot of unoptimised banking costs: transfer costs (especially cross-border costs), cost of float, banking system costs, etc.
- unsatisfactory degree of service within some banks (information, financial services, electronic banking, etc.)

This leads to:

=> unnecessary interest costs
=> unoptimised balance sheet - negative effects on Return On Assets (ROA)
=> lack of control and coordination - higher likelihood of costly errors
=> value date losses and relatively high transfer costs

=> unsatisfactory information about foreign exchange (FX) positions and excess cash - poor FX risk management/cash management capabilities

5.2.3 Setting up the objectives

The purpose of the Bank Evaluation -project was *to find the best banks in selected countries to serve Enso Group*. By doing this the company aims at:

- reducing idle cash and minimizing net interest costs both at subsidiary and Group level
- optimising the use of Group's cash resources
- reducing Group's balance sheet
- reducing the transfer costs and value date losses of both local and cross-border payments
- reducing the manual work where possible
- enabling the Group's Internal Bank to function properly
- maintaining subsidiaries' responsabilities in cash management
- ensuring a satisfactory bank service in each country
- ensuring adequate and reliable account information flows between the banks and the Group entities
- preparing for the new era of the Single Currency

5.2.4 Action plan and timetable

The nine countries participating the project were selected according to the importance of the currency in question. USD, GBP, DEM, FRF, NLG, ESP, BEF, ITL, and AUD represent over 80% of Group's total currency volume, so the selected countries were accordingly

the United States, Great Britain, Germany, France, the Netherlands, Spain, Belgium, Italy and Australia.

The criteria or areas of examination were decided according to the company interests:

- payments: incoming, outgoing, intragroup => charges and value date practices
- coverage of the bank network (and the local partner bank used)
- electronic banking capabilities
- lock box service (in countries with lots of cheque payments)
- EURO condition
- cash pool service:

- zero-balancing, notional pooling, varieties
- all charges and fees concerning the pool
- short-term credit facilities
- interest rates

An additional criterion was the banks' interest in participating the long-term funding of the Group and the future strategic outlook. This side was handled by the Financial Director and the Financial Manager of Enso Group. As already mentioned, the author was responsible only for the cash management part of the project.

The project was implemented as follows (year 1997):

March

- the project was introduced and accepted at Enso Oy (the Board meeting) and the author of this study was named to be resposible for carrying out the project
- getting familiar with Enso Group's organisation, account structure, payment flows and existing banks by doing observations and open interviews at head-office in Helsinki
- searching and studying the existing bank contracts

April

- clarifying the charges Enso is paying for different services within the existing banks
- choosing the alternative banks (a given list by the Financial Director)
- informing the Group about the project - an Internal Inquiry was sent to selected sales offices and production units (cf. Appendix 1)

May

• going through the feedback regarding the Internal Inquiry

• looking for a contact person at the alternative banks (telephone) and building up a relationship for further discussions => ca. 25 banks in nine countries

• preparing a Request for a Proposal to the alternative banks and searching for relevant information on transaction volumes for the Request letters (cf. Appendices 3-5)

• sending the Requests

June

• analysing the received proposals

• meetings in Amsterdam, Brussels, Madrid and Barcelona (Group people and alternative banks)

July

• analysing the received proposals

• interviewing banks' reference companies

• meetings in Paris and Milan (Group people and alternative banks)

August

• evaluations and conclutions

•preparing the end-report

In August 29th, 1997 the project was finished and the results and recommendations were given to the Financial Director, and later to the Board of Directors.

5.3 Findings and recommendations

In this section the findings of the empirical part together with the recommendations are presented in relation with the literature review (theoretical part). The purpose is to give answers to the following research questions indicated in the beginning of this study:

- How does the internationalization effect company's cash flows and bank relations?
- How do the banks try to meet the cash management needs of an international group?

First, an example of a country analysis in the Bank Evaluation -project is presented. All information is based on the sources mentioned in the section "data collection" and therefore, references are not made separately. An example of an evaluation chart used is presented in Table 2.

5.3.1 Country by country analysis (example: Spain)

5.3.1.1 General information

The banking situation in Spain is quite difficult from a foreign perspective. Even after recent rationalization programs (mergers, etc.) there are still hundreds of small and medium size banks in Spain and on the other hand, people like to keep accounts in several banks. Very often these banks are unable to provide the international companies with all the services they need. Additionally, a so called *float-game* is very common among the Spanish banks. This means that the bank intentionally delay in placing the incoming payments to company's account and by doing this the bank gains interest with company's money. Finally, the Bank of Spain regulations related to commercial payment services seem to have as many interpretations as there are interpreters.

5.3.1.2 Enso Group in Spain

In Spain (Madrid) Enso Group has a sales office, Enso Iberica, which handles the sales and marketing of products from Enso's Finnish and foreign subsidiaries. In other words, the products are exported from Finland and other foreign countries to Spain where Enso Iberica takes care of selling, invoicing, and credit control. The office is a fully owned subsidiary of Enso Oyj and it is run on a commission basis. Enso's customer base in Spain is widely spread which means that customers can be found in almost every corner of this large country and the number of banks used by customers is very high. Besides of the sales office Enso has also a production unit, Enso Española, which is located near Barcelona. This mill's products are sold both in Spain and abroad, and it is also 100% owned by the Group. These two companies are both considered as being *resident* companies in Spain, whereas the importing companies, e.g. the Finnish subsidiaries, have a *non-resident* status. Accordingly, the pesetas from Spanish customers to non-resident accounts are called "foreign pesetas" and those going to resident accounts are "domestic pesetas". Treatment of the two types of pesetas is different: in order to be accepted in banks the foreign pesetas need to be clearly indicated by special code in payment order.

When asked about the most important considerations related to banking the following issues came up:

<u>Enso Iberica</u>

- bank's help in solving the problem with erroneus payment instructions (cf. "existing bank" info)
- service/rapidity regarding all information
- charges (salaries, etc.)

<u>Enso Española</u>

- one bank close to the mill => personal contact
- competence in handling the type of payments (drafts) Española deals with and willingness to give always 100% committed service and information
- charges and interest rates

5.3.1.3 Existing bank and alternative banks

In the following parts Enso's existing bank in Spain and the alternative banks are commented. Due to classified nature of this data all names and figures are altered.

Enso Group's existing bank (Bank X)

Bank X is a global bank with around 100 branches in Spain. The Finnish subsidiaries and one German subsidiary hold accounts in Bank X in Madrid for collecting customer payments. Some foreign subsidiaries instruct their customers in Spain to settle theirs invoices directly to the home country of those subsidiaries, i.e. using cross-border transfers. Enso Española uses local banks; it has refused to use Bank X for collection purpose and therefore, it only has an account with Bank X for currency transfers with the mother company. The main reasons have been the level of charges and interest rates and expected inadequate service. Cash pooling has not yet been used; companies repatriate funds occasionally.

Problem areas:

a) Operative

Customers give erroneus payment instructions to their banks (they mark domestic pesetas instead of foreign ones) and when these payments arrive to Bank X they are stopped until the corrections are made. Many telephone calls, faxes, etc. has to be done between Enso - Bank X - Customer - Customer's bank before the money is actially credited to Enso's account. On annual basis the value date losses may be substantial.

Another inconveniance is the current system of cost statements. Bank X provides a periodic statement indicating only a lump sum for the period. Therefore, it is impossible in Enso Iberica to see what kind of charges have been deducted from one specific transaction. This violates Enso's general approach towards a better/total control over the bank charges.

In addition, the cash pool in Enso's required form is operational earliest in January 1998.

b) Economical

First, Bank X charges quite a lot for each incoming customer payment. Annually (according to volumes from 1996) this means a substantial total cost.

Second, the value date practise with incoming payments is incompetitive.

And third, Enso Española is not working with Bank X since it has found Bank X far too expensive compared to Spanish banks.

c) Quality of service

Enso Iberica has not been very happy with the service of Bank X. It takes often too long time to get the necessary information , e.g. if there has been confusion about the name ENSO (customers mix up the different Finnish subsidiaries) and Iberica tries to solve where the money actially has been tranfered to. And also, when the account responsible in Bank X is absent nobody seems to be able to replace her and provide the needed information.

It can be stated that the problems in Spain had existed already for a longer period of time and there was a clear need to examine the situation thoroughly and make comparisons with some alternative banks. One of the major issues was a receiving of correct value dates instead of waiting for weeks before the cash is on Enso's account. Naturally, the existing bank claimed that the customers are the ones responsible for these problems becouse they give erroneus payment instructions. This is of course true but Enso feels that the bank should be able to help in solving this problem and to show flexibility and this has not been the case.

Alternative banks

<u>Bank A</u>

Bank A is a global bank and it is quite strongly established in Spain (around 300 branches). It has very developped cash pool solutions, also for the future "Euro cross-border pooling". The bank offers reasonable charges and value dates in general (with some exceptions). As a global bank, its Euro condition is certainly among the best in Spain. On negative side it can be stated that there was lack of flexibility with solving the problem "foreign peseta vs domestic peseta". The bank said that "technically it would be possible but a tailor made solution would cost something for Enso". Another important issue was a high charge for FX-transactions.

Bank B

Bank B has experience in working with Enso Española and it is the largest bank in Catalonia region (one of Europe's industrial growth areas). After recent acquisitions Bank B is today the 6th largest commercial bank in Spain. It has a fairly good coverage with some 640 branches throughout the country. The bank shows good profitability and it has experience in international business (the biggest bank in export financing in Spain). Bank B offers reasonable charges and value dates and it is ready to take in the payments which belong to Enso but are missing some information, e.g. "foreign peseta" code, and to give the money a good value date instead of returning them. Problems with Bank B relate to harmonisation of the electronic banking systems which are still under work after the acquisitions. Additionally, the bank showed a quite light attitude towards EMU and its affects on bank's activities and systems.

Bank C

Bank C is very important domestically and according to some studies it is the most profitable bank in the world. The charges and value dates were in line with the other local banks. Response to the question of erroneus payment instructions was similar to the Bank B; so Bank C was willing to solve this problem. On negative side it can be stated that Bank C has no serious emphasis on foreign companies nor on international business (even finding English speaking personnel for the meeting was difficult). Also, it became quite clear that the bank is not preparing properly for the EMU.

Bank D

Bank D is the third biggest in Spain with 2500 branches. This bank could be regarded as being internationally oriented; it is specialized to serve non-resident companies. In Madrid Bank D has bilingual staff and against common practices they have "normal" working hours (9-17, no siesta) to be able to serve foreign companies. Bank D offers reasonable charges and value dates and it is willing to solve the "foreign peseta" problem as Enso wishes. Enso Iberica has had positive experiences in working with Bank D. Strong doubts, however, can be put to the bank's preparations towards Euro; they were not very convincing.

The following table was prepared according to banks' written offers sent to Helsinki.

Table 2. Evaluation of bank charges and value dates.

SPAIN bank charges + value dates

	Bank X	Bank A	Bank B	Bank C	Bank D
Incoming wires from Spanish clients to Enso's non-resident accounts					
Value dates					
Movement of funds berween Enso's non-resident accounts at the bank in question					
Value dates					
Outgoing payments from Enso's non-resident accounts to: a) Bank X Helsinki account with Bank X London and/or to a Spanish correspondent bank of any other bank, to cover FX transactions b) other Enso's accounts held outside Spain c) Enso Española resident account					
Outgoing/incoming payments from Enso Española resident account to any of Enso's non-resident accounts at banque in question or to any other non-resident entity					
Interest on balances: debit/ credit					
Cash pool charges: a) implementation b) maintenance					
Balance reports via SWIFT					
Payment orders via SWIFT					
Multibank service: installation monthly fee					

5.3.1.4 Recommendations and comments

After analysing all the alternatives a ranking of banks was made. A following recommendation by the author was stated:

"There seems to be a clear need for a bank change in Spain. Provided that the above mentioned negative issues with Bank A can be solved (certainly worth negosiating) it would be the best bank for Enso Group. From the local banks Bank B and Bank D gave the best impression on handling Enso's affaires...".

To conclude, Bank A fullfills best all Enso's requirements and additionally, it would be interesting to get to know this bank's way of handling cash management and the quality of its services, keeping in mind the global presence of Bank A as well as Enso's needs also in the future. The Bank A would be handling all customer payments of all Enso's companies which means that collection accounts would be opened in the new bank also for the foreign subsidiaries. Instead of cross-border transfers the money would be placed to company account in Spain => faster and cheaper. The resident companies will need a local bank close to them for running their business (salaries, rents, etc.), and the author recommends this to be decided and handled freely by those companies themselves. That is not a concern of the Group.

5.3.2 Benefits of the Bank Evaluation -project (example: Spain)

What are the benefits of this type of a research for the company? Provided that the open questions are solved, the bank change is implemented smoothly, and the quality of service meets the set requirements, the following advantages (from cash management perspective) can be found:

- Reduction of idle cash and minizing of net interest costs both at subsidiary and Group level => use of cash pool
- Optimisation of the use of Group's cash resources
- Reduction in the transfer costs and value date losses of both local and cross-border payments

• Automated transfer of account balances to Enso Oyj account (cf. cash pool solution of Bank A) => reduction of manual work in subsidiaries

• Reduction of Group's balance sheet (banking costs)

• Maintaining of motivation in Enso Española for credit contol => cf. cash pool solution of Bank A

• Competence in electronic banking capabilities and information systems

• Having a bank which will fit also to future (Euro) banking strategies

The cash management offer of Bank A is based on a local (ESP) cash pool solution which will be summarized in the following:

Cash pool solution for Enso Group (Bank A)

a) The pool will be centralized in a separate account in the name of the non-resident Enso Oyj.

b) Each night all participants will be zero-balanced, moving the positive or negative balance to the central account.

c) Future value-dated balances will also be moved, thus leaving each participant account with zero book balance.

d) The automatic transfers will be done at the end of the day, with one transfer for each value date of the funds.

e) Back values will be transferred with their corresponding value date, with up to six months of back value.

f) "The midnight effect": After midnight all automatic transfers will be reversed, so that the system has no net inter-company loans during the day. This means that the companies do not see the zero-balancing in theirs accounts; the balance in the morning is the same as it was in the evening. The movements of cash flows can therefore be still monitored and a higher motivation for credit control, especially in Enso Española, can be maintained.

g) A real-time global limit equal to the credit line will be available to all accounts participating the pool. The limit will apply to the sum of balances (negative balances reduced by positive balances) in all pool accounts at any moment.

h) Interest calculations detailed by transfer will be produced on a monthly basis and mailed to each participant. Display of current accrued interest is also available daily through Electronic Banking. The inter-company interest rates will be the same as the rates applied to the central pool account.

i) The Bank A will provide automatic bank reporting to the Bank of Spain.

j) The Bank A will provide the resident companies with the software permitting the printing of monthly DD2 forms for the Bank of Spain (a required reporting mode).

Bank A gave a detailed multi-media presentation at theirs premises on the structure and the functionality of the pool, and it is quite clear that the other banks participating the bid would not be able to offer a similar product.

As already mentioned, a similar analysis was made in eight other countries. In each country, however, the study had to be adopted according to local conditions and special features. For example, the questionnaire for the banks was different in each country because of different types of payments, companies, etc.

The other country analysis are not presented in this study simply because that was not the purpose of this work. This research paper aims at showing the importance of making an evaluation of cash management banks and the variety of criteria that is to be considered when operating in international business.

5.3.3 Future action plan

The final decisions and the implementation of bank changes as well as informing of all parties involved in the project, i.e. selected and rejected banks and the Group, will be done from the fall

1997 onwards. According to author's recommendations there is a need to make changes in six countries out of nine countries under survey. All Group accounts in each country should be operating smoothly well before the possible entering into EMU.

5.4 Answers to the research questions

5.4.1 How does the internationalization effect company's cash flows and bank relations?

When a company crosses the national boundaries the nature of its cash management changes quite completely. Most of the issues which affect the cash flows and banking requirements of an internationally operating company and which were handled in the literature review came up also in the empirical part with the case company.

First, the foreign subsidiaries do affect the cash management strategies of the case company. International expansion by establishing local operations has meant not just increased volumes and several currencies but also, more complex methods of payment as well as challenges in monitoring the liquidity position of the Group. The case company has followed the common pattern introduced in Chapter 2.3.2.2 namely, combining a decentralized cash management with a centralized financial control. So far the foreign companies have handled theirs bank relations quite independently and the number of different banks used has been large. Now, after the Bank Evaluation -project, all foreign units will have accounts in Group banks and a monitoring of the cash flows from the Group perspective is easier.

Second, internationalization requires knowledge on different cash flow optimization techniques. Together with the banks the case company tries to find the optimal solution for its various cash management needs. The most important issues have been the acceleration of cash inflows and the cash pooling. What comes to the lock box service, which has been developed to improve the handling of cheque payments, it can be stated that it can only be beneficial if the company has a sufficient amount of cheque payments per time period. Additionally, there are great differences between banks' charges so it is worthwile to make careful calculations and comparisons.

Third, cultural differences mentioned in the theoretical part were easy to reflect in the empirical study. Payment moral and personal relationships have a whole new meaning when operating outside of Finland. Findings in the case company about the credit times in different countries were quite comparable to those presented in Figure 5 (Average credit times in The European Union) Additionally, it become quite obvious that a resistance to changes is much higher the souther one goes. The first reaction in France, Italy and Spain seems to be that a change is something negative, always. Negosiation skills become very important when dealing with people in these countries.

Fourth, despite of the liberalisation of money markets, the governmental and legislative issues still affect the cash management of an international group to a great extent. In the case study it became clear that the banking conditions vary in each country, and it is necessary to know for example the Central Bank regulations concerning interests on current accounts, withholding tax legislation, non-resident company's status, etc. The EMU will certainly make some things easier for companies operating in the member countries (cf. Ch. 3.3.6), but a perfect harmonisation of national legislations is highly unlikely and therefore, these issues will continue to be important in international cash management.

Fifth, it can be stated that the international banking environment creates a lot of challenges as well as possibilities for the case company. In Back's model (cf. Figure 1) the case company can be positioned today somewhere between (inter)national and multinational stages having several product groups. During the internationalization phase the number of banks and accounts have increased rapidly. However, the future development in the banking strategy of the case company looks different than the one supposed in Back's model (Back 1988, 10-13). Instead of having even more complex banking structure the trend will be more likely in a concentration and the number of banks and accounts will be reduced.

In addition, a good coverage through a countrywide branch network is no more a prerequisite for successfull international business operations. A non-resident bank with only a few offices but with well-developed electronic capabilities, eg. a Swedish bank in Germany, can serve a large group without any problems. In Great Britain, for example, the foreign banks use local clearing banks and theirs branch offices to collect payments from British customers.

It can be concluded that if compared to the literature review both similarities to and deviations from the theories can be found when analysing the cash flows and bank relations of the case company.

5.4.2 How do the banks try to meet the cash management needs of an international group?

As already mentioned in the introductory chapter, cash management has obtained a new status among banks. When doing the empirical part in the case company it became clear that the banks are very actively offering help in organising the cash management of international companies. They provide the companies with brochures and publications on the latest development in the field, and they are eager to visit companies and to present theirs cash management solutions.

The case study did not bring up any new issues compared to the needs and challenges of an international group discussed in the literature review. What did come up in the Bank Evaluation - project was, that the banks are actively developing and improving the existing services, such as cash pooling. In addition, they try to provide the companies with tailor-made solutions rather than offering similar packages to everyone. And finally, all banks who want to survive in the expected "drop-out" game in the coming years are making the necessary investments in the research and development concerning the effects of The Single Currency. As discussed in Chapter 3.3.6, the Euro will have important effects on the banks as well as the companies, and there is a lot of potential in creating more efficent ways of organising the cash management. Since the case company has decided to change its business to be handled in Euros from the very beginning it was very important to find banks who are seriously preparing for EMU and are able to give assistance in its effects on cash management.

5.4.3 What are the key determinants of bank evaluation for corporate cash management in international business?

The answers to two sub-questions show clearly that the variety of criteria in bank evaluation is far more wider and more complex in the international environment than in purely domestic cash management. In respect of these higher challenges the bank evaluation should get the appropriate attention from the responsible for group's cash management. In author's opinion the key issue in an evaluation process of this extent and importance is to organise it as a project. Employees, who are doing their regular work, do not have time to concentrate properly on this type of matters, so it is important that a person or a team is signed specially for executing the evaluation. As discussed earlier, there is a lot of research work and travelling involved in the project, and in order to get reliable results it is important to reserve sufficiently time for the data collection.

Due to company internal factors and continuous changes in international environment, no standard criteria can be found in the cash management literature. Therefore, it is up to the company to determine the needs and crucial elements regarding its cash flows and bank relations, and to plan and execute its bank evaluations accordingly. By organising an open bid for the banks it is possible to get a lot of comparative information in a rather short time period, and the information can be adapted as needed. The data gathered from the existing banks as well as from the company itself, including the head office and the subsidiaries, can then be put against the offers of the tendering banks. An analysis should then be made without forgetting the qualitative issues, such as future outlook and strategic importance of the bank. The latest development in the international banking world shows that mergers and acquisitions are everyday life in the field and therefore, it is important for companies to follow the news and to try to predict the coming changes. In this case study the qualitative side was mostly handled by the Financial Management.

In addition to some general criteria, such as charges, value dates, reliability, etc., there were matters in the case company that received a special attention while evaluating the services of cash management banks. One important issue that came up was flexibility. A group, having the size and volumes like those of the case company, has the right to expect special services or flexibility in some cases, e.g. a dedicated account manager who can assist in all possible problems. Interestingly, this evaluation project gave clear signs about an uneven or unbalanced service level of so called global banks. They might offer very good and competitive services in one country, whereas in another country the quality and the pricing are badly out of line. This is something that should be considered when making the evaluations and the future strategies. Banks' flexibility can also be tested and used as one criterion in the evaluation process. Another important issue in this point of time is the banks' preparations towards EMU. If a bank, who wishes to serve an internationally operating group as the case company, does not have by now any material in English on its measures taken regarding the Single Currency, it is most certainly not the bank with whom a group should be operating on January 1st, 1999.

6 CONCLUSIONS

The purpose of this study was to enlighten the practical considerations of corporate cash management affecting bank evaluations in an international environment. The main research question was presented as follows: *What are the key determinants of bank evaluation for corporate cash management in international business?* The question was handled by searching for answers to two sub-questions:

- How does the internationalization effect company's cash flows and bank relations?
- How do the banks try to meet the cash management needs of an international group?

The literature review, Chapters 2 and 3, formed a theoretical framework for the empirical study presented in Chapters 4 and 5. The research method used was a case-study. The purpose of Chapter 6 is to summarize the major findings of this study and to give recommendations for further studies.

6.1 Summary

6.1.1 Theoretical implications

Importance of a profound evaluation process in bank selections has not been given much thoughts in the literature handling international cash management. Theories on efficiency in cash management and cash flow optimization models have been presented in several works but a research on practical company considerations dealing with the evaluation of service providers, the banks, has been lacking.

Compared to domestic business a company operating internationally faces completely new challenges. Monitoring the cash flows is much harder for a company having subsidiaries all over the world On annual basis an international group may loose substantial amounts just becouse of inefficencies in cash management, and better bank selections could bring help to the matter. According to this study it would be important that the head office people responsible for the cash management of the whole group rationalize the banking in each country and seek for the best

Theoretical framework: Factors affecting bank evaluation from international corporate cash management point of view

MICRO ISSUES

Company considerations

BANK RELATIONS

⇒ Growing number of banks and accounts
⇒ More and more complex banking network?

FOREIGN SUBSIDIARIES

⇒ Centralized or decentralized cash management?
⇒ Different CM techniques available accordingly
⇒ Maintaining of motivation

OVERALL FINANCIAL STRATEGIES

⇒ Short-term vs long-term strategies
⇒ Growth requires reliable relationships with financial institutions; "the other side of the coin"

MACRO ISSUES

Environmental effects

GOVERNMENTAL AND LEGISLATIVE ISSUES

⇒ Political, tax, and foreign exchange considerations
⇒ Differencies in possibilities to use certain CM techniques

CULTURAL DIFFERENCIES

⇒ Payment moral
⇒ Personal relationships

INTERNATIONAL BANKING ENVIRONMENT

⇒ Future development of wholesale banking
⇒ Retail banking:
- • CM services
  - technological capabilities
  - wideness of service selection
  - costs (incl. value dates)
  - network
  - quality of service
- • Future outlook (strategic fit)

⇒ EMU: threaths or possibilities?

possible benefits for the group. An evaluation of local as well as international and global banks is necessary in order to find the optimal solution not just within one country but globally as well, keeping in mind the overall banking set-up of the group.

In a bank evaluation process several issues have to be considered. First, cultural differences should not be neglected. This study showed that local participation in the evaluation process is crucial. Employees working in the country are the best source when the local payment practices and banking conditions are examined. Often it is necessary to collect the data by actially going to the country and discussing face to face with the company people. And after all, they are the ones who after the bank selections will be working with the new bank. Naturally they want to have a word already during the evaluation process. It can be stated, that a resistance from the foreign subsidiaries is one of the most typical problems within a project like this, and awareness of cultural differences and information skills as well as a sufficient time frame are needed. In these issues the findings in the literature were supporting the results of the empirical part.

Second, the cash management needs of an international group found in the literature were similar to those of the case company, and the same applied to the tools and techniques provided by the banks. A new observation was the emphasis that the banks are putting on a development and improvement of existing products and the activeness they show in advertising and selling their cash management services. It became clear that the cash management plays a new role in a corporate-bank relationship and this is something that one notices when organising a bank evaluation -project.

Third, an open bid for the banks is a practical way of gathering data for the evaluation purpose. However, a thorough familiarization with the local banking needs and payment practices in each country is necessary before preparing the requests for an offer. The study showed that, e.g. a standard questionnaire used in more than one country is not possible. Even in The European Union the banking conditions still vary considerably from one country to another and besides, there are always some company internal issues which influence the cash management needs.

Finally, it became obvious that there are great differences between banks in their preparations towards EMU, and from the company perspective this is one important criterion when making the evaluation on its cash management providers. As mentioned in the literature review, the Single

Currency creates a lot of opportunities for companies, so it is probably worthwile to examine and evaluate banks' actions on this matter and to select banks which give the best impression also from the future perspective.

6.1.2 Managerial implications

The official recommendations regarding the results of the Bank Evaluation -project summarized in Chapter 6 were given to the management of the case company as a separate version after the study. As the case company has officially declared its intention to head towards even higher degree of internationalisation, the author would like to present one concern, or recommendation, related to the evaluation study as well as to the internationalisation strategy of the company. In author's opinion not enough emphasis is put on group internal communication, both quantity and qualitywise. The major problems in the head-office-subsidiary -relationship were caused either by the lack of information or by information given in "military" manners, i.e. by using language and style unadapted to foreign business culture. If this kind of problems are not given thoughts and measures are not taken, the whole idea of further internationalisation is somehow absurd.

In general, this research work may benefit the cash management responsables of an international group by presenting the latest development in the field and by giving a detailed example of a large scale evaluation project. As mentioned in Chapter 2, a well-organised cash management is a relatively convenient way of gaining a competitive advantage: significant improvement in profits can be obtained with existing sales. Making a thorough evaluation and working with the best possible banks can be very prosperous for the company. Finally, the corporate perspective of this study might be interesting for cash managers in the banking sector.

6.2 Recommendations for further studies

Any of the issues handled in this study could generate further research topics. The actual effects of EMU on cash management, for example, should and most certainly will be under several studies after the introduction of the Euro. The role of banks in different businesses could be interesting target for further research. And naturally, a comparison of bank evaluation practices of several international companies would give a lot of additional value to the results of this study.

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Enso Iberica, S.A.

Nuottamo, Ohto. Managing Director, Madrid.

Guzman, Pedro. Head Accountant, Madrid.

Enso France S.A.

Di Méo, Claudine. Financial Manager, Paris.

Mathurin, Gottfried. Credit Control Officer, Paris

Enso Italia S.r.l.

Gonzaga, Marcus. Managing Director, Milan.

Pacchioni, Paolo. Credit Control Officer, Milan.

Enso Holland NV:

Söderström, Björn. Managing Director, Amsterdam.

Söderström, Mia. Credit Control Officer, Amsterdam.

<u>Banks</u> (personal discussions and/or telephone interviews; confidential)

34 Cash Managers/Account Managers in 34 commercial banks in following countries:

Australia, Belgium, France, Germany, Italy, The Netherlands, Spain, The United Kingdom, The United States

Reference companies

Sandqvist, Pär. European Cash Manager in Svenska Cellulosa. Sweden.

Olsson, Mats. Cash Manager in Atlas Copco Holding GmbH. Germany.

Ek, Maj-Len. Cash Manager in IKON AG. Germany.

Noren, Hans. Managing Director in Universe Tankships. The United States.

ENSO GROUP
FINANCE DEPARTMENT

APPENDIX 1

To: Enso Italia S.r.l./ Marcus Gonzaga
Subject: Enso Group's bank relations

Date: April 24th, 1997

Dear Marcus,

We would like to inform you about a project which has been started at the Finance Department of Enso Group in Helsinki. The purpose of this project is to examine the existing banks of Enso Group by making detailed studies on their efficiency in various areas (defined later), and to compare them with some alternative banks. The main objective is to find the best banks for the Group's cash flow management, since every penny lying unused decreases the Groups profitability.

Backround

Some of Enso's banks has been chosen, and the accounts been opened, even 50 years ago. After an important growth and structural changes within the Group, some of these banks may not be able any more to meet the needs of today's Enso Group. Some banks may not be able to handle efficiently the increased financial flows and to offer all necessary services.

Areas of examination

- Payments: incoming, outgoing, intragroup => charges and value date practices
- coverage of the bank network (and the local partner banks used)
- cash pool service:
  - zero balancing (top account + sub accounts)
  - costs
  - credit limit
  - interests
- lock box service (cheque countries)
- degree of preparedness towards Euro
- ADP-services (electronic banking)

⇔ Sales office

ENSO'S BANK ⇔ Local (client's) bank

⇔ Head office

The above mentioned factors have been considered important in terms of an efficient cash flow management. We would appreciate your comments on these factors, and even more important, we would like you, as a specialist of local needs, to present your experiences concerning the existing bank and its way of handling Enso's affaires. Please, give us also your comments on the alternative bank.

Existing bank: BANK X
Alternative banks: BANK A
B
C
D

The responsible of this project is **Mr. Henrik Nieminen** at the Finance Department. At the moment he is doing information gathering in head office, so all questions and comments should be sent to Helsinki. He will be visiting the sales offices and the banks abroad in May/June 1997.

We would like to emphasize the importance of your cooperation in this project, so please send/fax Mr. Nieminen all necessary information concerning the matter. We would appreciate having your report by **May 9th, 1997.**

Sincerely yours,

Veli-Jussi Potka
Senior Vice President, Controller

Risto Suuraho
Senior Vice President, Treasurer

Enso Group, Kanavaranta 1, FIN-00160 HELSINKI
Phone +358 2046 21436, Telefax + 358 2046 21307

APPENDIX 2

ENSO GROUP

Finance Department
Henrik Nieminen

AGENDA

Cash management/Bank relations

Meeting in Enso Italia S.r.l.
Milan, July 16th 1997

Participants: Mr. Gonzaga and Mr. Nieminen

ISSUES

1. Reasons for the cash management project

2. Enso Group vs. Enso Italia: "totally different environment"?

3. Reasons for delays in payments
   - customers
   - banks

4. Credit control
   - how is it organized
   - are all the charges controllable

5. Bank requirements
   - what makes a bank a good bank in Italy
   - what is the most important criteria for banks from Enso Italia's point of view

6. EMU discussions in Italy

Henrik Nieminen /eg,he 15/5/97 13:40

APPENDIX 3

MESSAGE
Subject: Enso's bank relations - FRANCE
Creator: Henrik Nieminen /eg,he

Dated: 15/5/97 at 13:23
Contents: 2

Item 1

TO: Claudine Dimeo /mkt,pr
Francoise Drouet /mkt,pr
CC: Henrik Nieminen /eg,he
Petri Wager /mkt,pr

Item 2

Hello!

Thank you for your response to our letter concerning Enso Group's bank relations.

For further evaluation I need to provide the banks with some detailed information, so could you please give me your estimates in following cases (Enso's cash flows in/from/to France):

1. Number/year and average size of received payments:

2. Clients' most used payment mode (cheque, electronic...):

3. Number of cheque payments:

4. Number of cross-border transactions/year:
   - incoming:
   - outgoing:

5. Daily average FRF balance in accounts (total):

I hope is able to help you with the matter. Should you have any questions, please do not hesitate to contact me.

Thanks and regards,

Henrik

PS. direct phone number: ~~+358~~ 2046 21243

ENSO GROUP
FINANCE DEPARTMENT

APPENDIX 4

TELEFAX

1997/04/03

To

Fax +

CC

From Henrik Nieminen
Finance Department

Tel. + 358 2046 21243
Fax + 358 2046 21307

No. of pages 1

Subject: Enso Group's bank accounts

Dear ______________________________,

Enso Group is making a survey on its bank transaction volumes in various countries, and since ______________________________ is handling our flows in ______________________________ I would appreciate it if you could provide me with the following information:

1) review of all the accounts belonging to Enso Group (resident/non-resident)

2) number of cheques per year (incoming & outgoing)

3) number and type of electronic payments (SWIFT, Telex, etc.) per year (incoming & outgoing)
   - -in ____________________
   - -international (cross-border)
   - -intragroup transfers within your bank

4) number of FX-transactions per year

5) any other payment method which would represent important flows?

6) today's tariffs concerning all above

Next two weeks I will be out of office, so please send me the data above by April 19th.

Thank you in advance and best regards,

Henrik Nieminen
Cash Management

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ENSO GROUP
FINANCE DEPARTMENT

APPENDIX 5

TELEFAX 1

2.6.1997

To BANK A

Fax

From Henrik Nieminen
Enso Oy

Tel. + 358 2046 21243
Fax + 358 2046 21307

No. of pages 4

Ref. Telephone conversation of week 22

Message: Demand for an offer (cash management services)

Dear Mr.

Enso is a Finnish forest industry group with a turnover of FIM 26 billion (USD 5 billion). After the latest acquisition in Germany in April 1997 the estimated turnover for this year is FIM 28 billion (2nd in Europe, 5th worldwide). Enso Group is listed at Helsinki Stock Exchange.

Due to a strong growth and many structural changes, our group has decided to put a strong emphasis on its bank relations and an efficient cash flow management. We have selected a small number of banks which we consider as potential banks for Enso Group. In principle, we want to have one bank in each country taking care of our cash flows, and the final selection will be based on your (and your competitors') offer.

We would like to have your presentation/tariffs on following issues:

1. **local cash pool** (see the details in enclosure)
2. **lock box service (cheque countries)**
3. **degree of preparedness and measures taken towards Euro**
4. **a) payments (domestic/cross-border)**
   b) electronic banking
   Please fill in enclosed Questionnaire for a) and b)

Due to a business trip I am unable to respond to your possible questions before our meeting in Madrid on June 17th (this week I will be at the office every day). Nevertheless, I am looking forward to seeing your offer and discussing closer about the matter in Madrid.

Yours sincerely,

Henrik Nieminen
Cash Management

ENSO GROUP
FINANCE DEPARTMENT

TELEFAX

2.6.1997

ENCLOSURE

Local Cash Pool for Enso

The main principes would be the same as we have here for Finnish pools.

- All Finnish subsidiaries + local operations should be included
- Every subsidiary takes care of its account independently and transfers the net balance to Enso account. This may happen once or twice a week according to the needs and flows.
- No overdraft limits are allowed for Finnish subsidiaries - limits for local operations are to be agreed separately
- Overdraft unlimited to Enso Oy (mother company) account
- Day to day interest to be agreed and credited to Enso account ONLY; your offer for interest rate?
- Overdraft limit applies to group account balance

In the case of Central Bank regulations preventing the above pooling please give your proposition for an alternative structure.

We are expecting no extra costs from this structure.

Specific information on Enso's cash flows:

1. Estimated turnover from Spain in 1997: ESP
2. number of accounts:

Enso Iberica (sales office in Madrid)

- non-residents (Finnish subsidiaries)
  - ENSO OY (mother company)
  - ENSO CARTONBOARDS
  - PANKAKOSKI BOARDS
  - ENSO PUBLICATION PAPERS
  - LAMINATING PAPERS
  - TERVAKOSKI
  - ENSO FINE
- residents
  - ENSO IBERICA (2 accounts)
  - ENSO GRAFIC (2 accounts)

Enso Española (production facility in Barcelona)

- number of resident accounts (ESP) + some currency accounts
- one account for transfers within Enso Group

3. Incoming wires from Spanish clients to Enso's non-resident accounts:
   - annual volume: ESP
   - annual number of transactions:

4. Outgoing payments from Enso's non-resident accounts to our present bank account in Helsinki and/or to a Spanish correspondent bank of any other bank , to cover FX transactions:
   - annual volume: ESP
   - annual number of transactions:

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ENSO GROUP
FINANCE DEPARTMENT

TELEFAX

2.6.1997

QUESTIONNAIRE (to be returned <u>in this form</u>; essential part of your offer)

A. Payments (domestic + cross-border)

Please fill in your tariffs and value date practices:

1. Incoming wires from Spanish clients to Enso's non-resident accounts

___

2. Movements of funds between Enso's non-resident accounts at . BANK A

___

3. Outgoing payments from Enso's non-resident accounts at . BANK A to:

a) a Spanish correspondent bank of any other bank, to cover FX transactions:

___

b) other Enso's accounts held outside Spain:

___

c) Enso Española resident account:

___

d) other beneficiary, either in Spain or outside Spain:

___

4. Outgoing/incoming payments from Enso Española resident account to any of the Enso's non-resident accounts at BANK A or to any other non-resident entity:

___

5. Interest on credit/debit balances in Enso accounts:

___

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ENSO GROUP
FINANCE DEPARTMENT

TELEFAX

2.6.1997

QUESTIONAIRE (continues)

B. Electronic banking

Charges:

1. balance reports via SWIFT ______________________________
2. payment orders via SWIFT ______________________________
3. the above when used your ______________________________
   Elect. Banking System ______________________________
4. costs related to your System (installation, monthly fees, etc.):

- ______________________________
- ______________________________
- ______________________________
- ______________________________
- ______________________________
- ______________________________
- ______________________________

C. Local partner bank used: ______________________________

Other information: